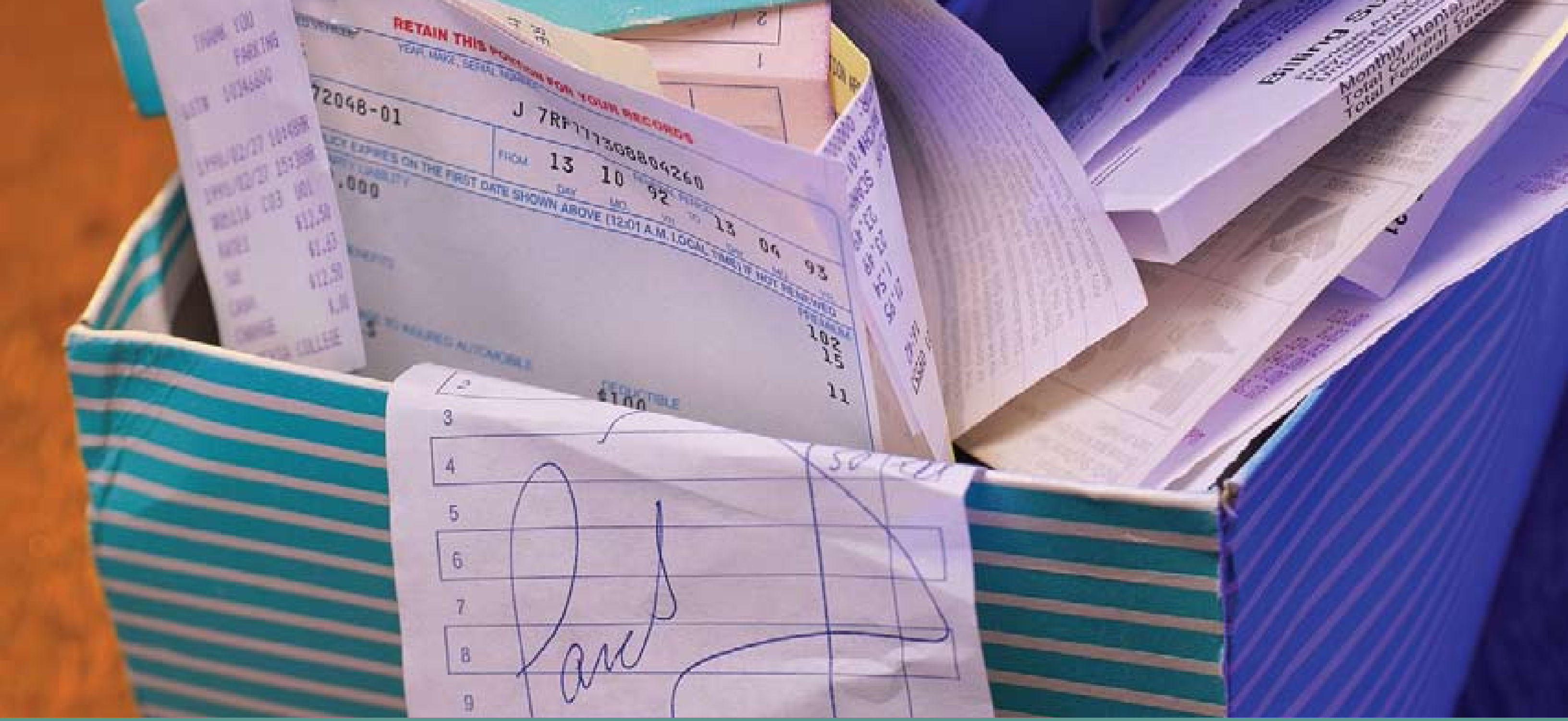

ON-SITE

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Don't get nickel-and-dimed by M&E expenses

Nickel-and-dimed. It's an expression most people are familiar with, but how does it happen to contractors? You might immediately answer with "fuel costs" or "licensing fees," yet an often overlooked way that construction companies lose cash flow is by failing to properly deduct meal and entertainment (M&E) expenses.

Of course, in the construction business, there may not be much "entertainment" involved in your M&E expenses unless you or one of your managers is entertaining a key client or prospect. Typically, however, contractors do incur a significant amount of these costs in providing food and beverages on job sites and during project meetings. And it's here that the nickel-and-diming can take place.

Construction companies must be extremely careful that they pay each employee no more than the appropriate per diem amount.

The popular per diems

To cover workers' food and incidentals, many contractors issue per diems. In this case, for tax purposes, you don't need to track each individual's expenses; you can use IRS tables for meals and incidentals as well as for lodging, meals and incidentals during out-of-town travel.

Bear in mind that phone expenses aren't considered "incidental" and may be reimbursed over and above the per diem amount. The IRS per diem tables list localities in the United States and abroad. They reflect seasonal cost variations as well as varying costs of the locales themselves — so a big city's rates may be higher than a smaller city's or town's.

If you prefer not to consult the IRS tables, you may use a simplified "high-low" method within the continental United States to reimburse employees up to $246 a day for high-cost localities and up to $148 for others. But this option is available only for lodging, meals and incidentals. It's not available for just meals and incidentals — lodging must be part of the equation.

Per diems' +/-

On the upside, the per diem method is simple and requires little record keeping. But it may better suit smaller construction companies that don't regularly incur a large amount of employee expenses. That's because construction companies must be extremely careful that they pay each employee no more than the appropriate per diem amount. The consequences of exceeding per diem amounts can be harsh. In fact, just a few years ago, the IRS issued a revenue ruling warning employers of the risks of mishandling per diem expense reimbursements.

Specifically, if you routinely pay allowances exceeding the federal per diem rates but don't fulfill the requirements for an "accountable plan" by tracking the allowances and requiring employees to document their expenses or pay back excess amounts (more on this below), the entire amount of the expense allowances is subject to income and employment tax.

An accountable plan

If you've run into trouble with your construction company's per diems, or you've recently found yourself at risk of running amuck of the rules, it may be time to establish an accountable plan. Here you create a formal arrangement under which you advance, reimburse or provide allowances for business expenses.

To be accountable under IRS rules, your plan must meet several criteria. You must pay expenses that would otherwise be deductible by the employee, and the payments must be for "ordinary and necessary" business expenses (such as lodging charges for out-of-town jobs). Also, employees must substantiate these expenses — including amounts, times and places, and purposes — ideally at least monthly. Last, workers need to return any advances or

Don't forget travel expenses

Contractors are often on the move — sometimes for short distances, sometimes for long ones. For this reason, it doesn't hurt to review the tax rules for deducting travel expenses. The good news is that they're generally 100% deductible.

Typical deductible travel costs include car expenses as well as those related to airplane, train, bus and taxi travel. If, like many contractors, you travel with your own vehicle, you may deduct actual expenses related to operating and maintaining it for the trip, or use the standard mileage rate and deduct business-related tolls and parking. (If you rent a car, you can deduct only the business-use portion of the cost.)

Other fully deductible travel costs include lodging, dry cleaning and laundry, and business-related phone calls. If you're traveling to a construction convention or trade show, bear in mind that you can fully deduct shipping expenses for samples or display materials.

allowances they can't substantiate within a reasonable time, typically 120 days.

If you fail to meet these criteria, the IRS will treat your plan as nonaccountable, transforming all reimbursements into wages taxable to the employee, subject to income and employment taxes — though potentially deductible by the employee.

Accountable plans' +/-

The primary advantage of an accountable plan is that your construction business may deduct the expenses (subject to a 50% limit for meals and entertainment) and employees may usually exclude 100% of the advances or reimbursements from their income. In contrast, deductibility of business expenses by an employee is subject to various limitations that may reduce or eliminate the benefit of the deduction.

The main disadvantage is that an accountable plan takes more time up front to establish and requires meticulous record keeping. You must support each expenditure with the details listed above. Again, the tipping point is the amount and nature of the M&E expenses your construction company typically faces.

Little things

As year end approaches, you'll likely have a number of larger tax issues to consider. For example, a couple of depreciation-related tax breaks ushered in by the stimulus act are due to expire. (Your CPA can tell you more.)

Little things such as M&E expenses can add up fast — particularly if ignored over the course of several years. Now may be the ideal time to take a look at these costs and ensure those nickels and dimes stay in your pocket. ☒

It's not too late

Make sure your construction company has a buy-sell agreement

We often don't realize we're missing something until we need it most. And so it goes with a buy-sell agreement (often simply called a "buy-sell"). Many construction companies soldier on without one until, sometimes quite suddenly, an ownership change occurs and the business is thrown into chaos.

So if you're missing a buy-sell agreement, it's not too late to get this important matter taken care of. And even if you have, regularly re-evaluating the arrangement is a must.

Stabilizing ownership

Essentially, a buy-sell agreement is a contract among your construction company's owners that sets parameters for the transfer of business interests. It determines the value of the business or defines the valuation method to use, and outlines when and to whom the interests can be sold.

A buy-sell agreement has many benefits. It can help preserve or transition the management and control of your construction company. A buy-sell agreement may also prevent conflicts among the remaining owners and the withdrawing owner's family members, while creating a market for the withdrawing owner's business interest.

If your construction company is family-owned, a buy-sell can be a huge plus, as it can be used to

establish a succession plan to safely transfer the company from one generation to the next.

Keeping it funded

Funding your buy-sell agreement ensures that the money will be readily available to cover the terms of the agreement and the purchase. Funding options include sinking funds, loans, savings plans, installment purchases and life insurance. (Your CPA can explain the details of each option.)

Using life insurance to fund your buy-sell is a popular method because it can help ensure that beneficiaries receive the agreed-upon price for the business shares in a timely manner. Life insurance can also provide buyouts that won't put a strain on your construction company's cash flow or force you to sell off assets to pay the bills. And it often preserves wealth and liquidity for the withdrawing owner or the deceased owner's estate.

Drawing it up

When business owners draw up a buy-sell, the arrangement generally takes one of two formats. The first is a cross-purchase agreement, in which the remaining owners buy a departing owner's shares. From a tax perspective, the surviving owners receive a stepped-up basis equal to the purchase price, which reduces income taxes in the event they later sell their shares. Also, because any life insurance proceeds used to fund the agreement bypass the company, those proceeds avoid any corporate alternative minimum tax (AMT) issues.

Cross-purchase agreements are, however, more difficult to administer because each owner typically must maintain separate insurance policies on the lives of all the other owners. So, for example, a cross-purchase agreement for a company with 10 shareholders would require 90 life insurance policies. (Using a separate partnership or trust can solve this issue.)

The second format is called a redemption agreement. Here the company buys back the shares. This arrangement is easier to administer — a 10-shareholder company would require only 10 life insurance policies owned by the company — but it can create tax problems. Surviving C corporation owners don't enjoy the benefits of a stepped-up basis, and the company may be subject to corporate AMT on the life insurance proceeds.

Confronting the task

This article only touches the surface of the complexities relating to buy-sell agreements. But the point remains — doing without (or failing to update) one is far more dangerous than confronting the task of creating a buy-sell.

So even if your construction company is blessed with plenty of work and a healthy backlog, it's worth your while to allocate some time to this issue. And if you're heading into a slow period, here's a good way to occupy your time. ☒

Looking back — and ahead — at bonding

Whether general contractor or sub, most construction company owners likely spend a considerable amount of time every year thinking about bonding. And you should — without adequate surety underwriting, you're severely limited in the number and size of jobs on which you can bid. So just where has bonding been and where is it going? Let's take a look.

Entering the 21st Century

The surety industry has learned some tough lessons over the past fifteen years — and, in particular, earlier this decade, when it incurred substantial losses because of many contractor defaults and some huge claims. Indeed, sureties paid out over $11 billion between 1994 and 2008, with half that amount being paid between 2002 and 2005, according to the Surety & Fidelity Association of America (SFAA).

Sureties are much better equipped to deal with economic uncertainties now than they were earlier in the decade.

That should explain the tightening of underwriting standards and tougher project analysis you likely noticed if you were in business in 2005. Since then sureties have done much better: The $718 million in claims paid out in 2007, according to the SFAA, was a big improvement from the $1 billion paid out in 2005.

Of course, in light of the recent recession, the economic landscape has changed yet again. Sureties are expecting the construction industry to slow down as contractors burn through their backlogs while residential and commercial developers soft-pedal new projects in light of the tight credit market. And with growth in many sectors looking dubious, the bonding horizon may seem dim.

But don't be so sure. Sureties are much better equipped to deal with economic uncertainties now than they were earlier in the decade, so bonding should be available. Plus, the stimulus package passed in February is driving infrastructure construction, which may put underwriters at ease while other sectors catch up.

Tried and true measures

One thing's for certain — sureties will be cautious and continue to demand complete and accurate financials before underwriting projects. Thus, maintain an active dialogue with your surety (they hate surprises!), choose your jobs carefully — with an eye toward profitability — and be organized and prepared when presenting your financial statements.

Also, continually work to improve your cash management and balance sheet. It can be a delicate balance, but consider deferring payment on accounts payable or speeding up billings for accounts receivable to improve year end cash balances. And watch key ratios such as debt to net worth, net worth to backlog percentage and earned revenue to net worth.

Like the weather

Bonding is much like the weather — it's not a matter of whether you can live with it, it's a matter of how. The good news is that the forecast may not be as dire as you might have imagined. And with the right approach, your construction company can stay in the clear. ☒

The Contractor's Corner

How can I better manage my equipment?

As this year heads to a close, one problem that leaps out at me is my equipment management. I've got leases and payment plans. I've got some pieces sitting dormant on the lot and others being driven into ditches by employees who weren't supposed to be operating them in the first place. Are there any simple steps I can take to better manage my equipment?

Simple steps? Probably not. Equipment management is a fairly complex — and expensive — area for all but the smallest construction companies. With so many moving parts (both literally and figuratively), it's all too easy to lose track of valuable pieces or leave operational procedures to chance. The best approach is to develop an overall equipment management program that allows you to track all your assets from acquisition to disposal.

3 big questions

To get started developing your equipment management strategy, ask yourself three big questions:

1. Should I lease or buy? First, take a look at your typical project types and develop some criteria for making this decision. Generally, leased equipment is best suited for shorter term projects, while purchases may make more sense for longer term jobs. Examining your usage patterns can help you evaluate your equipment needs and determine whether you've made the right decisions in the past.

2. Who will be using and servicing my assets? In your question, you mention an untrained or unauthorized employee operating a piece of equipment with dire results. This is a costly problem for many construction companies. Your equipment management program should include specific training regimens for every asset and a regularly updated log of which employees are authorized to operate which pieces. Think of it as a necessary part of your safety program. And to avoid getting stuck without qualified operators, keep a "live" list of qualified service providers.

3. Is our permitting and storage up to snuff? Lack of proper permitting can trigger fines that drive up your costs throughout the year. Similarly, faulty storage procedures can lead to damage and theft, which will further elevate your equipment costs. Factor your local permit requirements and expenses into your overall equipment management program and establish clear storage practices for every asset.

Integrate, integrate, integrate

As mentioned, the three queries above are just a starting point. You may also want to consider acquiring asset management software that allows you to integrate equipment leases/purchases and usage data into your accounting system. Doing so can significantly shorten the amount of time it takes to track your equipment and eliminate most questions as to who is operating what and when. ☒