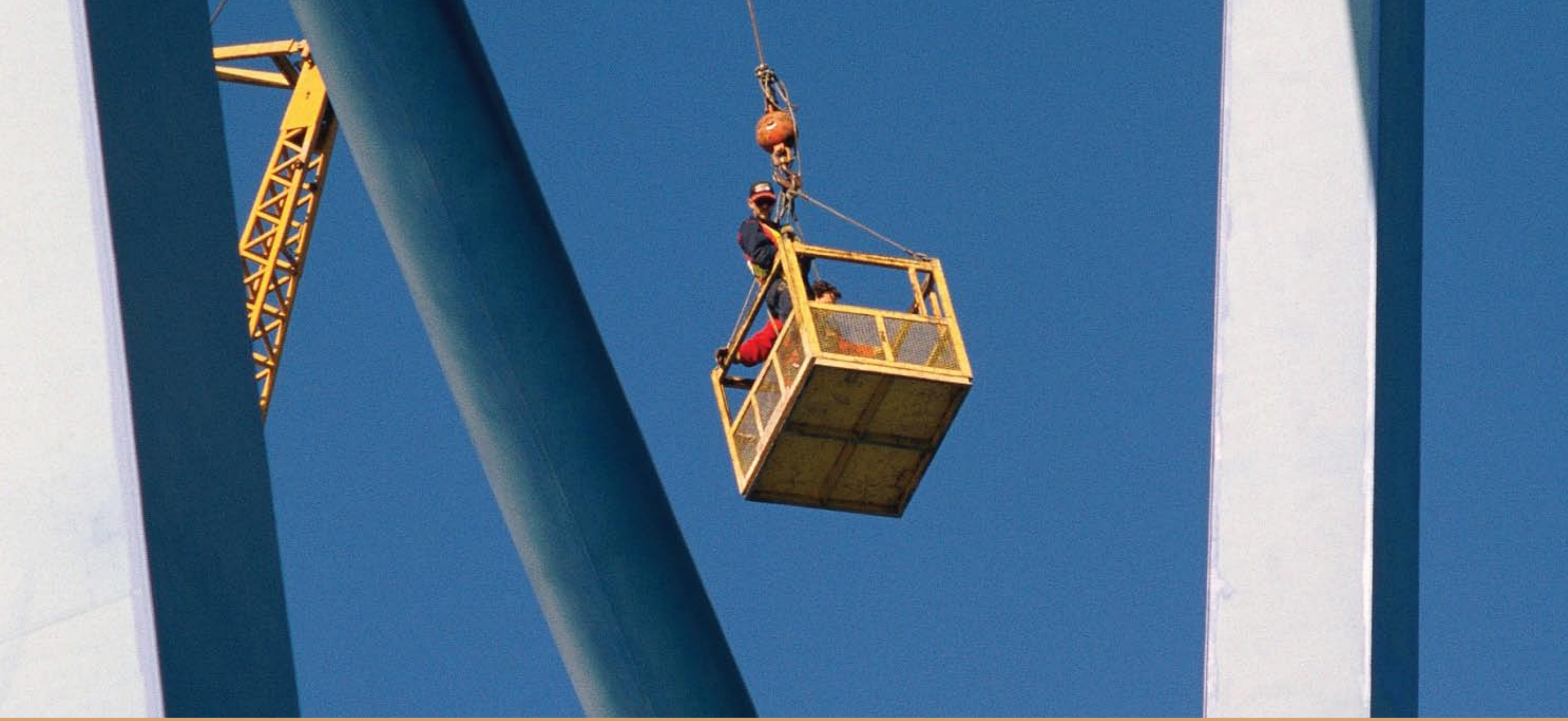

ON-SITE

Spring 2010

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Manufacture some tax savings this year

Section 199 deduction rises to new heights

If, like many contractors, you're looking to maximize your cash flow, you can't afford to leave any stone unturned. One way to keep more dollars in your pocket is to keep your tax bill as low as possible. To this end, there are a number of tax breaks you might want to consider.

One that may have slipped under your radar is the Section 199 deduction. This break has a couple of aliases: the qualified domestic production activities deduction and the manufacturers' deduction. Although those names may throw you off, the manufacturers' deduction may apply to many construction companies and, better yet, the maximum deductible amount has risen to new heights.

To get the most from the deduction, you'll need to identify "qualified production activities" that your business performs regularly.

Getting the gist

The manufacturers' deduction was introduced in 2004 via the American Jobs Creation Act. As its name indicates, the law's target audience at the time was manufacturing companies. But other industries were invited into the fold as well — including architecture, film production, software, engineering and, most important for our purposes, construction.

To get the most from the deduction, you'll need to identify "qualified production activities" that your business performs regularly. In the building realm, these generally involve construction or major renovation of real property such as residential and commercial buildings. Tasks related to infrastructure projects such as road, power line, water system and communications facility jobs also may qualify.

Once you've identified the qualified production activities, you'll need to determine the taxable income derived from those tasks. This comes from the gross receipts arising from the lease, rental, exchange or other transfer of qualifying production property minus out-of-pocket expenses, such as materials costs.

Calculating the percentage

In this very simplified explanation, to arrive at your deduction, you must choose from the lesser of either your taxable income derived from your qualified production activities or your entire taxable income for the year.

Now, finally, the good news: After beginning at a mere 5% in the introductory 2005 tax year, and going up to 6% for the 2009 tax year, the deduction has risen to 9% for the 2010 tax year. The catch, however, is that the deduction can't exceed 50% of the W-2 wages paid to employees during the calendar year.

Let's look at an example of how the manufacturers' deduction works: Getting out our crystal ball, we see that Contractor X will earn $550,000 in taxable income on $3.5 million in gross receipts in 2010, entirely from qualified production activities. Assuming Contractor X's W-2 wages are adequately substantial, its deduction at the new 9% rate will be $49,500, for a $17,325 tax savings.

Bear in mind that, to obtain savings of this nature, you'll likely have to do some extra administrative work tracking your qualifying construction activities and the related costs (labor, materials expenses and so forth). Because determining the deduction amount is complex, be sure to work with your CPA.

Cutting your losses

As you can see, your construction company's taxable income — both related and unrelated to qualifying

NOL extension could still be an option

If your construction company suffered a net operating loss (NOL) in 2008 or 2009, here's some good news: Recently renewed NOL rules now permit most businesses to carry back their NOLs for up to five years, instead of the previous two.

You must elect to make a carryback by the deadline for filing a return (including extensions) for your last taxable year beginning in 2009. Furthermore, you may claim NOLs that occurred in tax years ending after Dec. 31, 2007, and beginning before Jan. 1, 2010. For the fifth year, your carrybacks are limited to 50% of that year's taxable income.

Small businesses with gross receipts not exceeding $15 million may apply the five-year carryback to both the 2008 and 2009 tax years. If you don't qualify under this criterion, you'll have to choose between either 2008 or 2009 — you can't claim both.

Another positive change brought about by the NOL extension involves the alternative minimum tax (AMT). Before the extension, losses claimed for AMT purposes were limited to 90% of the AMT NOL. Now you're allowed to carry back 100% of your AMT NOL. Doing so could bring some additional savings to a company that typically ends up paying some AMT tax.

Like the manufacturers' deduction (see main article), the NOL rules are fairly complex. But they can provide a substantial benefit if followed properly.

activities — plays a huge role in gaining access to this tax break. Of course, that means that, if you have no taxable income for the year, you can't benefit from the deduction. So if you've had a particularly rough year, you may need to look at other tax strategies.

One to consider is the net operating loss (NOL) deduction. Although you generally can't use the manufacturers' deduction to create or increase an NOL, you may be able to accelerate some income into the current year to take advantage of the NOL deduction. To learn more, see "NOL extension could still be an option" on page 3.

Making it a good year

Last year brought great challenges to many construction companies. To help make 2010 at least a little better, make sure you use every weapon in your arsenal. Ask your tax advisor whether the manufacturers' deduction is something you can take into battle come tax time and, if so, how you can get the most from it.

Are you ready to upgrade your financial management software?

Investing in top-of-the-line financial management software can lead to fewer mistakes in estimating, bidding, project management and job-cost accounting. In short, an upgrade in your technology can help your construction company better compete in today's tough marketplace.

But the dizzying array of applications makes this a difficult buying decision — especially for a contractor who's trying to keep busy on the job site. To get a better handle on what you need, let's look at each of the major steps in such a purchase.

Questions to get started

Strange as it may sound, technology upgrades demand a bit of soul searching. That is, when making the decision, you need to think about what your construction company truly needs and will be able to use. What type of system and functionality would you like? Do you need a basic estimating software program? Or would a more powerful system that integrates financial, project management, purchasing and inventory activity be more appropriate?

Assuming you already have some technology systems in place, compatibility is an issue, too. If you're using an older operating system, new software may not be compatible. In that case, you'll be looking at additional costs to have an IT consultant update the older applications or upgrade both hardware and software.

When making the decision, it's recommended that you also get input from your staff. For example, your accounting and scheduling personnel should be able to tell you what types of reports they need from a new system. From there, you can develop a "wish list" that you can use to compare different packages.

In addition, talk to customers who use the software you're considering and ask them questions on "the good, the bad and the ugly" with the application features. They also can grade the vendor's technical support — a critical factor with any software purchase. Also ask other contractors who've used the software for at least one year to see if they're satisfied with their purchase.

A vendor "hot list"

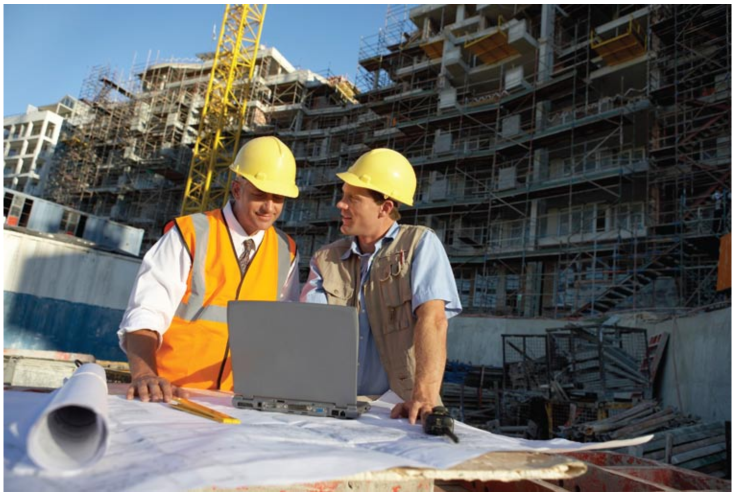
As you might expect, there's no shortage of vendors selling financial management software. So, just as you'd do your homework on a heavy equipment purchase, do it for your software as well.

Generally, longevity will be a plus. Look for companies that have been in business for at least five to 10 years and have a track record of successful implementations, and a long list of satisfied customers. Also find out what kind of technical support is included with your software purchase.

You could jeopardize the entire purchase by failing to implement the software upgrade properly.

For example, is on-site software training part of the package? If not, you'll likely need to send your IT person out for training, which could cost you additional dollars in travel expenses. In addition, if you buy a top-of-the-line system but the vendor's customer service is nonexistent, you and your employees won't be happy.

Your ultimate goal is to create a "hot list" of the top vendors. With your list in hand, you can get to the serious business of comparing and contrasting the various bids. To aid you in this critical decision, ask for free trial periods or extensive online demos



to help you determine the best product for your construction company.

Implementation tips

Once you've decided on a product and vendor, there's still one more important step you must take: implementing the software. You could jeopardize the entire purchase by failing to implement the software upgrade properly.

For starters, designate a project manager to lead the transition to the new application. Next, back up both your existing programs and data in case the upgrade doesn't "take" the first time around. And, before "going live" with the new application, create a test environment to give it a try.

Finally, bear in mind that training and support will be very important over the long haul. Allocate enough time for your employees to get proper training on the new system, and consider engaging an outside consultant to be on call for technical questions and issues. This will help ensure you and your employees get the most out of the upgrade.

From horror to happy

You've likely heard horror stories of construction companies that haphazardly attempted to upgrade their financial management systems only to lose time and money fixing the resulting problems. Approach this task cautiously to ensure your upgrade story has a happy ending.

4 ways to better manage materials expenses

Contractors struggling to control costs aren't getting much help on the materials front. Persistent overseas demand coupled with a rocky and slow-to-recover economy has turned many, if not most, materials purchases into key business decisions. As this struggle continues, here are four ways to better manage your materials expenses:

1. Renegotiate with your vendors. Sometimes the quickest and easiest way to get a price break is to ask for one. Specifically, try to establish firm, reasonable materials prices with your suppliers for a set period.

Another move to consider, if your cash flow allows, is to buy in bulk. Doing so can be a great way to lock in discounts. And though it may not earn you a price break, try to place your orders as early as possible. This can enhance your vendor relationship and may lead to cost savings down the road.

2. Reuse and recycle. You've probably heard a lot about going green for environmental reasons, but here's another one. Many job site materials can be recycled (wood, metal and cardboard, for instance). You may even be able to boost your cash flow by selling some of it, such as scrap metal.

Review some of your typical projects to see how recycling and reusing materials may work for you. Also, contact your local waste management agencies and area waste haulers to see what opportunities may be available.

3. Learn about and promote value engineering. Sometimes to lower materials costs, you must go on the offensive and become an educator. If owners are demanding materials that are driving up everyone's costs, maybe it's time you promoted an alternative concept known as value engineering. This concept assesses the function of each project area and tailors materials choices appropriately. For instance, in low traffic areas of a building, less-expensive light fixtures and flooring could shave valuable dollars off your costs.

4. Consider stockpiling. The concept of stockpiling materials when you may be struggling to find the cash to buy *anything* may seem counterintuitive. But if you've got the opportunity (perhaps a vendor offers you a great deal on a bulk purchase), the dollars and the storage space, this is an option to consider.

It's unlikely that the international market for materials is going to evaporate overnight. Big countries such as China and India, as well as smaller ones such as Dubai, will probably continue to build on a large scale, keeping the worldwide demand for construction materials high and lowering supply. So making the ambitious move to stockpile materials now could benefit you in the long run. ☒

The Contractor's Corner

Stimulus act boosts ceiling for SBA surety bonds

The economy in my area has been slow to recover, and jobs aren't easy to come by. To make matters worse, I've been getting signals from my surety that it may not be willing to cover me as well as it previously has. I'm not ready to give up on it yet, but I'd like to have some alternatives at the ready just in case. Any ideas?

When you go out in search of bonding, the federal government probably doesn't immediately leap to mind. But the Small Business Administration (SBA) is an option and, thanks to recent legislation, they have some pretty good offerings.

Boosting the bond

What makes SBA surety services particularly attractive right now is the fact that the agency's bonding amounts recently got a big boost.

Specifically, a provision in the American Recovery and Reinvestment Act of 2009 — also known as the stimulus act — increased the maximum amount of bonding the SBA can offer under its Surety Bond Guarantee Program from $2,000 to $5,000. The SBA will guarantee bid, payment and performance bonds to qualifying companies at these amounts through September 2010 on all public and private contracts and subcontracts. It does so by partnering with members of the surety industry and covering 70% to 90% of the bond amount.

What's more, in July 2009, the SBA agreed to raise the maximum amount it will guarantee for federal contracts to $10 million. The bonding uptick on government projects fits together nicely with the expected rise in the number of such jobs, thanks to the stimulus act. "These changes support small and emerging businesses nationwide," said SBA

Administrator Karen Mills. "Particularly construction contractors who have seen their markets hurt by a poor economy and lagging construction."

Learning more

If you haven't checked into the SBA's Surety Bond Guarantee Program lately (or at all), now's a good time to do so. The agency recently established a new electronic bond application process that greatly speeds up applicants' ability to obtain bonding. All application forms are available online and can be transmitted, expedited and approved electronically.

The SBA also offers a Preferred Surety Bond Program that allows selected bonding firms to issue SBA-backed loans without the agency's prior approval. This is something to consider when shopping around for bonding providers.

Knowing your options

If you already have a good, established relationship with a surety, you probably shouldn't abandon it just to give the SBA a try. A strong, time-tested surety arrangement can be a huge benefit to a construction company. But SBA-backed bonding is an intriguing alternative that has recently gotten much more attractive. To learn more about what the agency offers, check out its Web site at sba.gov.