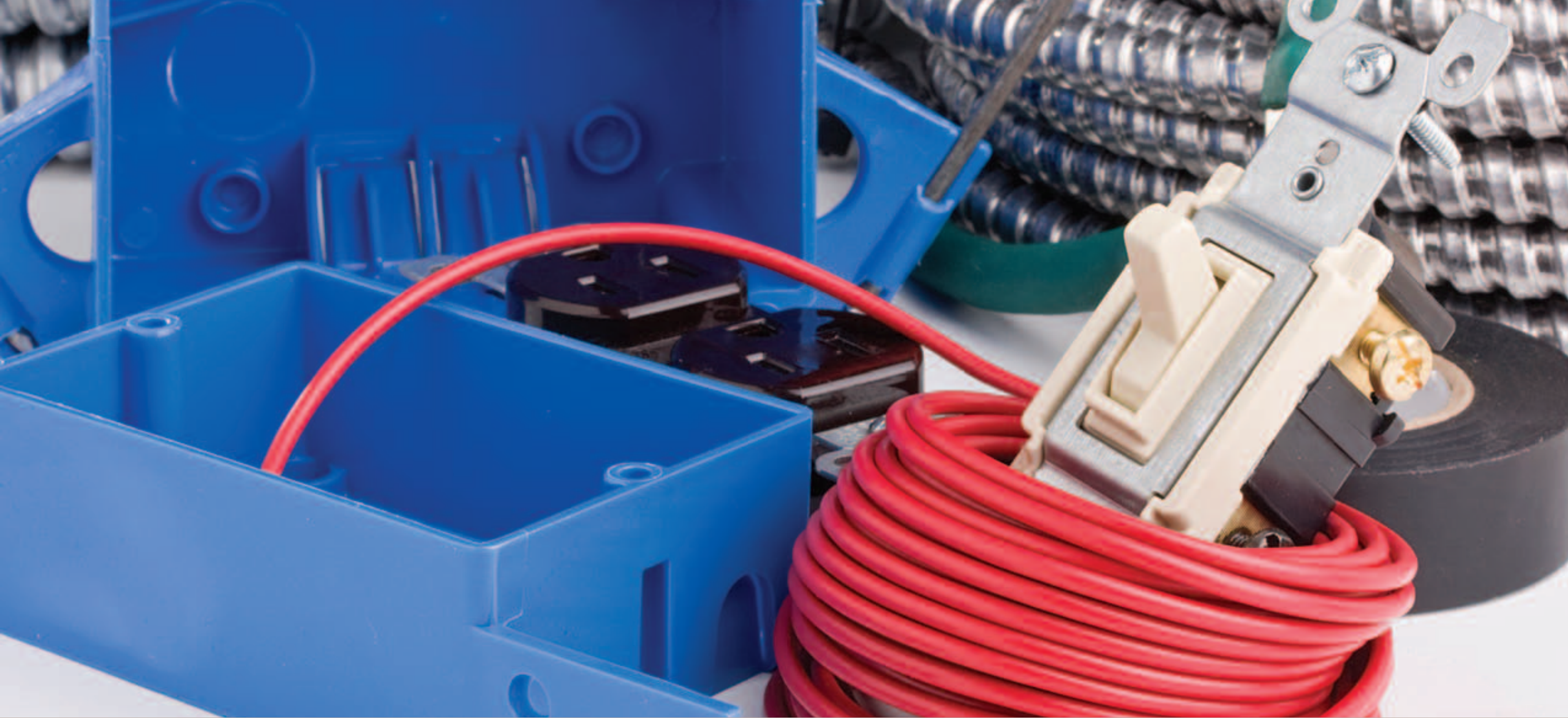

ON-SITE

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Tangible changes

Revised IRS regs address deducting vs. capitalizing property

Tangible property plays a significant role in what contractors do. Whether it's an owner's building, property your company owns or leases itself, or materials and supplies related to your trade, tangible property — and its tax impact — is central to your operations.

Earlier this year, the IRS released its much-anticipated revised regulations on the tax treatment of expenditures related to tangible property. The regulations, which took effect on Jan. 1, 2012, address when expenses related to tangible property can be fully deducted in the current year (which creates an immediate tax benefit) vs. when they must be capitalized (which creates a series of smaller deductions over a period of years).

Defining materials and supplies

One way the revised regs may directly apply to your construction company is the changes they bring to the definition of "materials and supplies." That is, the regulations define materials and supplies as tangible property used or consumed in the taxpayer's operations that:

- Is acquired to maintain, repair or improve a unit of tangible property owned, leased or serviced by the taxpayer, and
- Isn't acquired as part of any single unit of property.

Also defined as materials and supplies are units of property that had an economic useful life of 12 months or less (starting when the property was used or consumed) and units of property with an acquisition or production cost of $100 or less. Many fuels, lubricants and the like that

can reasonably be expected to be used within 12 months also fall under the definition.

Any tangible property that meets the definition of materials and supplies can generally be deducted when used or consumed, rather than capitalized.

Addressing building improvements

For building owners — whether that be you, a customer or a prospect — the revised regs address the important question of whether tangible property has been repaired (a generally deductible expense) or improved (which typically requires capitalizing).

The "improvement standard" of the IRS defines an improvement as a betterment, restoration or adaptation of a unit of property. Under the new regs, to determine whether an expense is an improvement for a building, the taxpayer must now apply the standard separately to the building's primary components, which are the structure itself or any of its specifically defined building systems. Examples of the latter include the electrical, plumbing and HVAC systems.

The expected result of the new regs' change in the unit of property is that property owners will have

to capitalize more expenses. For instance, if you replace an entire HVAC system on one of your properties or that of an owner, the improvement will no longer be currently deductible as it previously would have been; it will have to be capitalized.

On the bright side, the new regs expand the definition of "dispositions" to include the retirement of a structural component of a building. This means a property owner can recognize the disposition of the component as a loss before the entire building is disposed of rather than have to continue to depreciate the component for many years after it has been disposed of. So some tax benefit may arrive more quickly, and the administrative requirements are simplified.

Handling building components

When it comes to tangible property other than a building, the revised regs address the handling of "functionally interdependent" building components. The IRS defines these as components in service that depend on the placement of another component in service. (Special rules may apply to plant property and network assets such as telephone, cable, water and sewage lines.)

If the taxpayer initially assigned a different economic life to a component for financial reporting or regulatory purposes, that component no longer needs to be treated as a separate unit of property. So, basically, the regs remove some of the prior requirements of specific asset identification and depreciation. Taxpayers now can treat related property as one unit.

In addition, the revised regs provide a new safe harbor that makes it easier for taxpayers to deduct certain "routine" maintenance costs for tangible property other than buildings. An activity isn't considered an improvement if the taxpayer expected to perform it as a result of his or her use of the property to keep the property in its ordinarily efficient operating condition.

The IRS further defines an activity as routine if, when the property was placed in service, the taxpayer reasonably expected to perform the activity more than once during the property's life.

Raising your visibility

As you can see, the revised Sec. 263 regs aren't for the faint of heart. Work with your tax advisor to determine how they apply to your construction company's tax planning and reporting. ☒

De minimis rule applies to some property acquisitions

Thinking about acquiring some tangible property for your construction company in the near future? You may have to capitalize the cost of the purchase — or you may not.

Under the revised Section 263 IRS regulations (see main article), there's an exception to the capitalization requirement for certain acquisitions. That is, you may deduct the cost for tax purposes (up to a threshold) if you:

- Expense the purchase price of the tangible property for financial reporting purposes, and
- Follow the proper written accounting procedures for expensing those amounts.

That threshold we mentioned: The aggregate amount paid and not capitalized must be less than or equal to the greater of 0.1% of the gross receipts for the tax year for income tax purposes or 2% of the total depreciation and amortization expense for the tax year.

This "de minimis rule" does apply to the purchase of many materials and supplies, which, under previous rules, you couldn't claim a tax deduction for until you used or consumed them. Ask your tax advisor whether any of your construction company's commonly used materials or supplies qualify.

Avoiding the common mistakes of construction project management

A construction company's profitability weighs in large part on how effectively it manages its jobs. You must maximize efficiency, minimize waste and seize every opportunity to build your bottom line (and without rubbing owners the wrong way).

Unfortunately, in the rush to do all this and get to completion, many things can go wrong. Let's look at some of the common mistakes in construction project management — and how to avoid them.

Risk, schmisk

The economy's recovery from the recession continues to be slow and uncertain. So it's understandable why contractors would leap at just about any opportunity for work available to them.

Granted, every construction company needs to gain new jobs to succeed. But taking on projects that are either too big or too unfamiliar in nature can wind up costing you more dollars than the projects bring in.

That's why good project management teams know their respective companies' strengths and don't view risk as a roll of the dice. Rather, they see it as an analytical, quantifiable concept. In this sense, risk management has become a critical aspect of every construction project.

Taking on projects that are either too big or too unfamiliar in nature can wind up costing you more dollars than the projects bring in.

A variety of probability models allow you to calculate the likelihood of a given risk and adjust your building plans and job-site configuration accordingly. Specific risks measured can range from something as general as an inexperienced client to something as specific as the need for specialized lifting equipment given the nature of the job site and potential weather conditions.

Bidding on the kinds of jobs at which your construction business has excelled in the past will more likely have the lowest risk and bring productivity gains. To facilitate this effort, create a historically based prebid checklist of objective and subjective criteria to evaluate every potential job.

Numb to numbers

The best project management teams don't just set productivity expectations in a prejob planning meeting and then forget about them. They regularly generate meaningful job cost reports and crunch the numbers.

As projects roll along, keep an eye on the key financial ratios that drive your business. For example, the current ratio (current assets / current liabilities) can give you insights into your capacity to meet your short-term liabilities with cash and other relatively liquid assets. Generally, this ratio should be at least 1.0, though 2.0 is a better goal to shoot for.

A variety of software is capable of creating these reports, which can include charts and other graphics to illustrate productivity and budgetary data. As you obtain new financial information about a project, be ready to redefine your profitability goals for the job. Specifically, make sure the scope of the contract remains in balance with the remaining job tasks.

The silent treatment

Once a job is underway, there's a natural tendency to put your nose to the grindstone and focus more on doing the work than talking about it. But stellar project management teams establish clear lines of communication with everyone involved and *use* those lines regularly.

In addition to obtaining the information they need from owners, these teams clarify project requirements with superintendents, subcontractors and suppliers — and they stay in close touch with

these parties during the job. Of course, in-house communication is important, too. Consider holding at least weekly, if not daily, meetings with your crews to discuss job progress as well as to set and review production goals.

And the communication shouldn't stop when the project is over. It's often been said that the wisest among us are those who learn from their mistakes. The same holds true for project management teams. The standouts take the time after completion to review their work.

All too familiar

Do any of these mistakes sound all too familiar? If so, don't beat yourself up — they're called "common" for a reason, and you can address and improve on all of them to the great benefit of your construction company. ☒

Green builders, rejoice: Here come the apps

For nearly 20 years now, the U.S. Green Building Council (USGBC) has spearheaded the sustainable construction movement. Its Leadership in Energy and Environmental Design (LEED) certification program offers contractors the opportunity to execute environmentally friendly projects while expanding their own knowledge of, and prestige in, the field of green building.

If your construction company already is working on some LEED jobs or may seriously consider one in the near future, good news arrived late last year: In November 2011, the USGBC

launched its App Lab as part of its LEED Automation Program.

Popularity explosion

The massive popularity explosion of apps — third-party software designed to enhance our daily business and personal lives in virtually every conceivable way — inspired the USGBC to create the LEED Automation Program. Through this initiative, the USGBC seeks to:

- Speed up and standardize LEED project communications,
- Innovate ways for all pertinent parties to view job data across multiple platforms, and
- Open the LEED documentation process to third-party app developers.

That third point is where the App Lab comes in. Its concept: a searchable catalog of third-party apps enriched with LEED data and capable of helping contractors (and others) with a variety of tasks related to a sustainable job.

Specific examples

The App Lab launched with eight apps ready for use on LEED projects and, as of this writing, the USGBC's website (usgbc.org) shows 15 partners. The organization expects to add many more in the coming months.

One of the apps offered right now is Greengrade (the name of both the solution and the developer). It's a Web-based project management tool that offers anywhere/anytime assistance with task assignments, file uploads and project reporting. The app even provides strategies and resources for multiple LEED rating systems.

Another offering is GreenWizard by GreenWizard Inc. It helps design firms and construction companies evaluate, select and document building products during all job phases to ensure LEED compliance. GreenWizard also allows users to invite an unlimited number of participants to collaborate on a given construction project. And the software enables you to create and modify LEED checklists as well as maintain a running list of favorite green building products.

Apps are enriched with LEED data and capable of helping contractors (and others) with a variety of tasks related to a sustainable job.

Close attention

Sustainable building has, well, sustained itself. Despite the tentative nature of the economy and slow construction markets in many areas, green projects continue to spring up nationwide.

If your construction company is looking for a competitive edge, establishing or expanding its presence in this niche could be it. Just bear in mind that LEED certification isn't easy to get. The amount of documentation and, indeed, technology involved is considerable and will require close attention. ☒

The Contractor's Corner

How do I stop nickel-and-dime fraud?

I own a midsize asphalt paving company. Because my business is family owned and operated, we've never had a problem with fraud at the management level. I know who's who and what my managers are up to. But we still seem to lose a significant percentage of revenue to what I call "nickel-and-dime fraud." A few small tools here, a mileage overage there — it adds up. Any suggestions?

There are so many ways unscrupulous employees can nibble away at a construction company's bottom line. Although you can likely never completely eliminate misdeeds, the broadest way to attack the problem is to create a fraud-averse culture.

Flooding the company

As you might expect, a fraud-averse company culture starts at the top. It's good that you know and trust your managers, but doing so doesn't mean you're invulnerable to fraud at this level.

Your upper-level management and project managers need to buy in to the idea that fraud prevention is a regular part of their jobs — not just an occasional "special project." These key employees have to

know how to spot and address potential risks at all times.

But that's not enough; managers also need to communicate an antifraud attitude down the organizational chart. If adversity to fraud doesn't trickle — or, better yet, flood — down to the lower levels of your business, the nickel-and-diming probably won't stop.

Training from the start

Creating a fraud-averse culture means training employees from the start to spot and report fraud. Provide this training upon hire; for existing staff, schedule fraud-specific training sessions before starting new projects.

The fact that fraud is a constant issue in your construction business may indicate that workers don't have a good way of reporting it. Anonymous hotlines, for instance, are effective. Set one up and, during training sessions, make staff aware of it. Another option: Place a "suggestion box" either outside or within every job trailer where employees can drop anonymous notes.

In addition, inform workers of the *consequences* of financial theft or unauthorized use of assets. Take a zero-tolerance policy against blatant crimes (such as stealing cash) and consider probation and retraining measures for "grey area" misdeeds (such as personal use of a company vehicle).

Doing it all

For contractors, fraud is a many-faceted thing. It can happen in the office, on the job site or at a storage facility. Your best bet is to create a company culture that provides education, allows for an easy means of reporting, and discourages wrongdoing at *every* level. ☒

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