

PERSPECTIVES ON THE CONSTRUCTION INDUSTRY

WR Webster Rogers LLP
CERTIFIED PUBLIC ACCOUNTANTS ♦ CONSULTANTS

www.websterrogers.com

Winter 2012

Sizing Up Joint Venture Opportunities

Have you ever considered entering into a joint venture with another construction company? A joint venture may be an opportunity for your firm to leverage its unique capabilities, expertise, and resources with another firm to take on one or more projects that would otherwise be difficult, if not impossible, to do alone.

Potential Advantages

A successful joint venture may benefit your construction company in several ways.

Access to Different Markets. Having a joint venture partner with strong relationships in locations where you have none can broaden your company's geographic reach.

The knowledge of local market conditions that a partner may bring to the relationship could result in more accurate bids and better labor relations.

More Resources for Larger Projects. Combining financial and equipment resources, personnel, and expertise may allow you to bid on bigger, more complex projects. Having a joint venture partner that provides additional working capital can reduce the likelihood of cash shortfalls, facilitating successful project completion.

Greater Bonding Capacity. Sureties may view the combined resources of the

joint venture partners as a better underwriting risk, making it easier to obtain bonding at competitive rates.

“Although joint ventures have potential benefits, many issues need to be addressed up front.”

Matters for Consideration

Although joint ventures have potential benefits, many issues need to be addressed up front.

Like any new undertaking, you'll increase your chances of success with the joint venture if you iron out the issues and perform due diligence with respect to the other business entity before you finalize an agreement.

Deciding on a Structure. How the joint venture is structured is crucial.

Will it be a partnership, limited liability company (LLC), or corporation in which individuals generally enjoy limited liability exposure? Carefully consider the tax implications and how profits, losses, and liabilities will be shared.

Defining Responsibilities. Many administrative and organizational details will need to be spelled out in the agreement. The agreement should clearly assign specific responsibilities to each party.

Issues such as who bears responsibility for maintaining books and records and for overseeing day-to-day operations should be agreed on from day one.

Assigning Costs. The joint venture agreement should specify how and at what rates equipment, materials, and services will be billed to the joint venture.

Managing Cash. Decide ahead of time which party will control the project's cash.

Talk to Us

If you have considered undertaking a joint venture with another firm, we recommend you talk to us first. We can help you analyze the financial aspects of the proposed venture to help you determine whether it is appropriate for your company. ✓

Reimbursing Employees' Temporary Living Expenses

You've landed a large job in a community about eight hours away from your home base. You estimate the project will take three months and will require a half dozen workers and a foreman. Since you can't expect your employees to commute back and forth each day, you've made arrangements for them to live in a motel near the site for the duration of the project. Your question: What is the best way to handle payments for the cost of lodging, food, and other expenses for the crew?

Set Up an Accountable Plan

An accountable plan is a reimbursement or expense allowance arrangement that must meet three basic criteria:

- (1) The expenses must have been incurred in connection with services performed for your company.
- (2) Employees must "adequately account" for their expenses. (Specific requirements apply.)
- (3) Employees must return any excess reimbursement or allowance within a reasonable period.

Under this arrangement, your employees would not be required to report the reimbursements as income, and your company would not owe any payroll taxes on the reimbursed amounts. Your company can deduct the expenses, subject to the 50% limit on meal and entertainment expenses.

Consider Per Diems

This approach to employee business expenses helps simplify your business's recordkeeping. Instead of reimbursing actual expenses, you would pay a per diem allowance no higher than the applicable federal per diem rate. Per diem rates vary for different parts of the country since the cost of living varies from place to place. Employees will still have to substantiate the time, place, and business purpose of their trips under the per diem method.

Employees may receive excludable travel reimbursements while they are *temporarily* away from their "tax home" on business. However, if an assignment is indefinite (lasting more than one year), reimbursements are taxable. ✓

Fine-tuning Your Internal Controls

If your company's internal controls are not up to speed, you're exposing your business to a number of risks. Without adequate internal controls, you may be making decisions based on inaccurate financial information. Moreover, weak internal controls heighten the possibility that your company could fall victim to theft and fraud.

Contractors are particularly vulnerable to accounting errors and outright fraud since they often have operations at several different work sites. Fraud is a particularly serious issue: Businesses lose an estimated 5% of annual revenues to fraud each year, according to the Association of Certified Fraud Examiners. Areas that your company should pay particular attention to include the handling of cash, accounts receivable, and accounts payable.

Handling Cash

You may be leaving your company open to a fraud opportunity if you give sole responsibility for processing cash transactions to a single employee. All cash-related functions should be shared by two or more employees as a safety precaution. Be sure that bank account reconciliations are

done monthly, and consider requiring two signatures on checks, especially for large disbursements and payroll.

Personally reviewing your bank statements can alert you to potential problems. Have the statements sent to you directly and promptly review them. Watch out for out-of-the-ordinary items, such as unfamiliar payees.

Reviewing Accounts Receivable

As a practical matter, you should track amounts owed and when accounts are due if your company is to maintain a healthy cash flow. Establish procedures that ensure bills are prepared promptly. Follow up on accounts receivable on a standardized schedule, and record and deposit all cash receipts, segregating collection and bookkeeping responsibilities. You should preauthorize any amounts that are written off as uncollectible.

Tracking Accounts Payable

This is an area of construction where the potential for fraud and accounting errors

is high, particularly if your company is working at multiple job sites. You can limit the potential for losses by instituting tight controls on materials and purchasing. Consider requiring management authorization for job site material purchases, and be sure to set limits on the amounts site managers can spend without authorization from an additional, higher level of management.

You should put procedures in place to make sure that delivery receipts are being checked to ensure that all ordered items have been received. And track whether ordered materials and equipment are being used as intended by requiring written verification and receipts for returned items.

Implementing and consistently enforcing effective internal controls can help your company control costs, maintain profit margins, and reduce the potential for fraud and theft. If you would like to know more about improving your internal controls, please consult with us. ✓

What Work Qualifies for the Domestic Production Activities Deduction?

One attractive tax break available to many construction companies is the domestic production activities deduction (DPAD), which is basically a tax deduction for a percentage of a company's "qualified production activities income" (or taxable income, if less). The applicable deduction percentage is currently 9%.

A recent Tax Court decision* in favor of a construction firm clarifies some of the issues surrounding the DPAD and provides important guidance in several areas.

Case Background

The firm involved in the case is engaged in engineering and heavy construction activities, including erecting or rehabilitating bridges, streets, airport runways, and other related real property. For the 2006 tax year, the firm reported \$25.9 million in domestic production gross receipts (DPGR) for work it did on improving a series of old bridges and repairing other inoperable bridges. The work entailed adding lanes, ramps, driveways, traffic rails, bridge decks, and retaining walls to existing roads.

The firm claimed its receipts from the bridge projects were eligible for the DPAD

since the work consisted of erecting or substantially renovating real property. The IRS disallowed the deduction, claiming the firm had no DPGR for the year in question. The IRS said the firm's work was routine maintenance that simply restored the bridges' operating condition. The IRS also claimed the company was engaged in repair work since not all of the bridges' components were replaced.

real property that materially increases the value of the property, substantially prolongs its useful life, or adapts the property to a new or different use.

Taxpayer Victory

The court ruled in favor of the construction firm and allowed the tax deduction. It noted that the receipts in question qualified as DPGR because the firm's work:

"The distinction between 'repair' and 'substantial renovation' is important...."

Repair or Substantial Renovation?

The distinction between "repair" and "substantial renovation" is important because activities performed in connection with a project to substantially renovate real property can qualify for the deduction. The DPAD regulations define substantial renovation as renovation of a major component or substantial structural part of

- ✓ Materially increased the value of the bridges
- ✓ Significantly prolonged the bridges' useful lives
- ✓ Helped adapt the bridges for new and different uses

For More Guidance

The DPAD issue is quite complex. If you need clarification on this or any other tax-related issue, please contact us. ✓

* *Gibson & Associates, Inc.* 136 TC No.10

Can Your Company Qualify for a DPAD?

To claim the DPAD for construction work, a contractor must:

- ✓ Be engaged in the active conduct of a trade or business treated as a *construction activity*
- ✓ Carry out construction activities involving *real property* in the U.S.
- ✓ Derive *DPGR* from the construction activity

Real property includes buildings and inherently permanent structures (other than machinery) and their structural components, inherently permanent land improvements, oil and gas wells, and infrastructure. Structural components include walls, partitions, doors, wiring, plumbing, central air conditioning and heating systems, pipes and ducts, elevators and escalators, and other similar property. Infrastructure includes roads, power lines, water systems, railroad spurs, communications facilities, sewers, sidewalks, cable, wiring, and inherently permanent oil and gas platforms.

The general information in this publication is not intended to be nor should it be treated as tax, legal, or accounting advice. Additional issues could exist that would affect the tax treatment of a specific transaction and, therefore, taxpayers should seek advice from an independent tax advisor based on their particular circumstances before acting on any information presented. This information is not intended to be nor can it be used by any taxpayer for the purpose of avoiding tax penalties.

WR WebsterRogers LLP

CERTIFIED PUBLIC ACCOUNTANTS • CONSULTANTS

www.websterrogers.com

1411 Second Loop Road / 29505
PO Box 6289 / 29502
Florence, SC
843-665-5900 (ph)
843-678-9523 (fx)

1759 North Fraser Street / 29440
PO Drawer 1628 / 29442
Georgetown, SC
843-546-2426 (ph)
843-546-0028 (fx)

Parkway Center, Suite 201
950 48th Avenue North
Myrtle Beach, SC 29577
843-448-1500 (ph)
843-447-2588 (fx)

380 West Wesmark Blvd
Sumter, SC 29150
803-905-4000 (ph)
803-905-4001 (fx)

Carolina First Center, Suite 320
40 Calhoun St. / 29401
PO Box 20099 / 29413
Charleston, SC
843-577-5843 (ph)
843-723-3075 (fx)

Litchfield Commons, Suite 2A
14361 Ocean Highway 17
PO Box 350 / 29685
Pawleys Island, SC / 29585
843-237-9004 (ph)
843-237-9160 (fx)

The Tower at 1301 Gervais
Suite 802
Columbia, South Carolina 29201
803-312-0001 (ph)
803-265-8886 (fx)

100 South Main Street, Suite G / 29483
PO Box 1588 / 29484
Summerville, South Carolina
843-873-4400 (ph)
843-873-7227 (fx)

Building For Your Future

*A Full Array
Of Services*

- ✓ Tax Planning & Consulting - Licensing, Multi-State Tax & Bonding
- ✓ Financial Statement Audits and Reviews for Licensing, Bonding, & Financing Purposes
- ✓ Monthly Financial Statements & Customized Management Reports
- ✓ Management Consulting (M&A Advisory and Business Consulting)
- ✓ Accounting Services Support (AP, Check Writing, & Management)
- ✓ Software Solutions & Support
- ✓ Employer Services Group (HR, Employee Benefits, Payroll)
- ✓ And More . . .

WR WebsterRogers LLP
CERTIFIED PUBLIC ACCOUNTANTS • CONSULTANTS

Florence, Charleston, Myrtle Beach, Columbia, Georgetown, Sumter, Litchfield, Summerville

Contact Us

wr@websterrogers.com

www.websterrogers.com

Developments in Tax and Business

W-2 Reporting of Health Coverage

The health care reform law included a new requirement that the cost of employer-sponsored health insurance coverage be reported on Form W-2. The new requirement was to take effect starting in 2011, but the IRS has made it optional for all employers for the 2011 Form W-2. And for eligible small employers, the new requirement will be optional through at least 2012.

2012 Plan Limits

The IRS has announced increases in retirement plan contribution limits for

2012. In general, plan participants in 401(k) plans can now defer up to a maximum of \$17,000 of wages in 2012. The limit for employees age 50 or older making catch-up contributions stands at \$22,500. The limit on annual additions to a defined contribution plan account is \$50,000 for 2012.

Social Security Limits for 2012

The Social Security Administration announced that the taxable wage base for 2012 is \$110,100, up from \$106,800 in 2011. Wages above this cap are not subject to Social Security tax, but all wages are subject to Medicare tax. ✓

Can We Serve You?

Our firm provides a broad range of accounting, auditing, tax, employee benefit, and management consulting services to contractors.