

PERSPECTIVES ON THE CONSTRUCTION INDUSTRY



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Knowing When To Repair or Replace Equipment

Construction work is hard on equipment. Regular use in a wide range of conditions can wear out even the best maintained equipment and vehicles. At some point, you will have to decide whether it still makes financial sense to repair and maintain existing equipment or whether the time has come to replace it with something new.

A good way to assess the replace-versus-repair decision is by calculating the hourly cost of owning and operating your current equipment and its potential replacement. Replacing a piece of equipment typically makes sense if its hourly cost (after considering the cost of repair) exceeds the hourly cost of the potential new or used replacement equipment.

Calculating Hourly Costs

Hourly costs should be based on the same utilization projections for the current equipment and the proposed replacement. The major factors to consider in the hourly cost calculations include:

Machine value loss. This refers to the yearly loss in market value (taking into consideration tax deductions for depreciation).

Capital costs. This is the equipment's cost multiplied by your business's

weighted cost of capital, adjusted for taxes.

Miscellaneous ownership costs. These would include taxes, permits, insurance, and administrative overhead associated with the equipment, adjusted for tax benefits.

Operating costs. These include the after-tax costs of fuel, oil, repairs, and maintenance, as well as other operating costs.

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Downtime costs. Using an hourly rental rate, annual downtime costs can be projected by factoring in machine availability and utilization.

Productivity differential. The difference between the machines is accounted for on an after-tax basis.

These calculations are performed for each year of the expected useful life of the current equipment. Ideally, the equipment should be replaced in the year

the sum of its hourly costs exceeds the sum of these costs for the replacement.

Buying Equipment

The Economic Stimulus Act of 2008 (ESA) should prove very helpful to contractors that purchase equipment in 2008. Eligible taxpayers may elect under Section 179 of the tax code to deduct as a business expense the cost of new or used assets placed in service during the year. This “expensing election” is

taken as opposed to claiming depreciation on the asset. The ESA raises the previous \$128,000 expensing limit to \$250,000. The overall investment limit jumps from \$510,000 to \$800,000. It is possible that you may be able to claim a deduction for the full cost of the equipment and machinery you place in service this year.

The ESA also allows an additional first-year depreciation deduction equal to 50% of the adjusted basis (generally, the cost) of qualifying new equipment. The adjusted basis of the equipment is then reduced by the bonus depreciation when computing regular depreciation on the equipment. This additional first-year deduction is generally available for property placed in service after December 31, 2007, and before January 1, 2009. ✓

Retaining Key Employees

Contractors know that good supervisors and skilled employees can make the difference between bringing in a project on time and on budget and missing those targets. Their value to the company rises in tough economic times. How can you be sure that your business's key employees won't be tempted by an employment offer from a competitor? You can use a combi-

and a degree of independence generally won't cost you much, but the rewards for your firm can be substantial.

Inexpensive and Free Incentives

Many incentives are cost free. Non-monetary rewards can range from recognizing an "employee of the month" to

performance-based plans and discretionary incentive compensation plans.

A performance-based plan is one in which the incentive compensation can be a fixed percentage of the profits that the company or the supervisor's division has earned. Alternatively, it can be a fixed percentage of the profit earned on an individual contract. Another variation entails paying additional compensation only when individuals achieve specific objectives.

Discretionary incentive compensation plans reward key employees whose contributions to a project or to the business are evident to owners but are difficult to measure using traditional benchmarks. This plan design gives you the latitude to reward those individuals who, in your judgment, are most valuable to your business's success.

Only you can decide the most appropriate way to reward exceptional employees. However, in these tough economic times, retaining key employees should be a priority. ✓

"High performing employees want respect for their skills, judgment, and abilities."

nation of common sense, pay, benefits, and nontraditional rewards to keep key employees on your team.

Respect and Autonomy

High performing employees want respect for their skills, judgment, and abilities. Since they thrive on challenges, they also want responsibility, a degree of autonomy, and freedom to work without someone constantly looking over their shoulder. Giving key employees respect

a simple face-to-face expression of thanks for a job well done. Relatively inexpensive incentives include gift certificates, spot cash awards, and additional paid vacation days.

Incentive Compensation Plans

You can structure a plan so that the compensation can be paid currently or deferred to a later date, such as retirement. Two possible approaches are

Recycling Waste Construction Materials

The standard practice in construction is to pay someone to haul away the waste construction and demolition materials that are typically generated on every job. Most contractors regard the disposal of concrete, wood, asphalt pavement, asphalt shingles, drywall, and metal as simply a cost of doing business.

Going the Recycling Route

However, some savvy contractors are recycling waste construction materials on site and reaping some serious rewards. It's a win-win situation all around. Contractors may be able to reduce their waste disposal costs since some recyclers charge less to accept materials that can be profitably recycled. Recycling also keeps these materials out of landfills. Just as important, contractors will be able to

attain points toward the U.S. Green Building Council's Leadership in Energy and Environmental Design (LEED) certification for their recycling efforts. (LEED certification is granted during the construction phase for using recycled materials (or those with recycled content) or recycling construction waste. An increasing number of owners are requiring this certification from their construction contractors.)

Getting Started

Start by contacting local and state agencies in charge of recycling waste. They'll be able to tell you what's recyclable and what's not. Currently, most construction waste can be recycled, but facilities may vary by state and region. Concrete, for example, is widely recycled as road base, general fill for drainage, and for pavement

aggregate. Recycled asphalt shingles can be used as aggregate for new asphalt hot mixes. Drywall can be ground up and reused for gypsum wallboard and in the manufacturing of cement.

Local and state agencies can also give you contact numbers for local recyclers. Certain recyclers accept mixed loads of materials and sort the debris out themselves. If your projects generate significant amounts of construction debris, it may even be economical to recycle on site. Homebuilders, for instance, can grind up clean wood, drywall, and cardboard for use as a soil amendment.

You can find out more by going to the U.S. Environmental Protection Agency's Construction and Demolition (C&D) Materials website at www.epa.gov/epaoswer/non-haz/debris/new/index.htm. ✓

Estate Planning Pointers for Contractors

You may be thinking about selling your construction firm at some time in the future. And you want to be certain that the proceeds from the sale of your business, as well as the other assets you have accumulated over the years, will provide financial security for you and your loved ones. You also may have concerns about how your assets may be affected by income, gift, and/or estate taxes. What, for example, would the estate-tax consequences be if you transferred your business to a child or other relative?

These are all legitimate concerns. However, careful estate planning can help you accomplish your goals and avoid many of the traps that can reduce the size of the inheritance that eventually will pass to your family and/or other beneficiaries. Here are some of the issues related to estate planning that you ought to consider.

Start with a Will

If you die without a will, you'll have no control over what happens to your property. Rather, the state's laws will govern the disposition of your assets. With a will, you can specify who gets what after you die, who administers your estate, and who is appointed guardian of any minor children you may have. In addition, a will may help speed up the settlement of your estate. Even if you have a will, it may need to be revised if you sell your construction firm or experience another major life event.

Have a Buy-sell Agreement

A buy-sell agreement is an effective way of ensuring the orderly transition and management of your construction firm and that surviving family members will be fairly compensated should you or a co-owner die. It is a contract between the owners of a business under which each owner agrees that, typically, on death, disability, or retirement, his or her business interest will be sold to the other owners (or to the business itself) at a price (or using a price methodology)

that's determined under the agreement. The buy-sell agreement also can be triggered under other circumstances defined in its terms, such as bankruptcy, divorce, or other legal action that could threaten an owner's business interest. Just as importantly, the agreement should have a mechanism for providing the funds needed to make the purchase.

Maintain Adequate Life Insurance

Life insurance is often a key component of an effective estate plan. It can provide the funds necessary to pay a variety of expenses and meet your family's ongoing cash flow needs following your death. Life insurance can also be used in conjunction with a buy-sell agreement to fund the purchase of a deceased business owner's shares, providing liquidity to the owner's family.

"Trusts can help you reduce taxes and accomplish other, equally important objectives."

Create a Plan

You may want your children or other family members to take over your business. You can accomplish this goal more effectively through careful planning. A good plan should examine how your business interest will be acquired by the younger generation and how that acquisition will be financed. Moreover, a carefully considered succession plan should seek to protect the company's value and its ability to compete. It should also help minimize your estate taxes.

You can capitalize on what's known as the "federal gift-tax annual exclusion" by giving your children company stock over time. Every year, you can give cash or other assets worth up to \$12,000 — per recipient — without any federal gift-tax consequences by using the gift-tax annual exclusion. Your spouse can do the same. Or, with a gift-splitting election, a gift can come from one of you and be as much

as \$24,000 by using both of your gift-tax annual exclusions.

Use Trusts for Tax Savings

You can leave everything to your spouse and your estate generally won't have to pay federal estate taxes, thanks to the federal unlimited estate-tax marital deduction provisions. However, assets that remain in your spouse's estate when he or she dies could be subject to federal estate tax if those assets exceed the applicable exemption amount for federal estate-tax purposes.

Trusts can help you reduce taxes and accomplish other, equally important objectives. Trusts can also:

- ✓ Provide asset management and protection
- ✓ Unify an estate plan
- ✓ Help avoid probate
- ✓ Ensure the future financial security of surviving family members
- ✓ Meet charitable giving and philanthropic planning goals

Get Expert Advice

You can protect what you own from unnecessary taxes and ensure your loved ones' future financial security. Professional advice is critical.

Talk to us. ✓

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.

www.websterrogers.com

1411 Second Loop Road / 29005
PO Box 6389 / 29562
Florence, SC
843-668-8900 (ph)
843-678-9523 (fx)

1759 North Fraser Street / 29440
PO Drawer 1628 / 29442
Georgetown, SC
843-548-2428 (ph)
843-548-0028 (fx)

Parlow Center, Suite 251
900 48th Avenue North
Myrtle Beach, SC 29577
843-448-1300 (ph)
843-497-2589 (fx)

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

Carolina First Center, Suite 300
40 Calhoun St. / 29403
PO Box 20089 / 29413
Charleston, SC
843-577-5843 (ph)
843-723-3075 (fx)

Exchange Commons Building, Suite 2A
14381 Ocean Highway 17
PO Box 100 / 29685
Pawleys Island, SC / 29685
843-237-9004 (ph)
843-237-9100 (fx)

The Tower at 1301 Geneva
Suite 912
Columbia, SC 29201
803-312-0001 (ph)
803-256-8888 (fx)

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WR WebsterRogers LLP
CERTIFIED PUBLIC ACCOUNTANTS • CONSULTANTS
Florence, Charleston, Myrtle Beach, Columbia, Georgetown, Sumter, Litchfield

Contact Us

wr@websterrogers.com

www.websterrogers.com

Developments in Tax and Business

Mileage Rate Increases

The optional mileage allowance for owned or leased autos increased 8¢ from 50.5¢ to 58.5¢ per mile for business travel from July 1, 2008, to December 31, 2008. The rate increase applies to the use of owned or leased autos, vans, pickups, and panel trucks. This mid-year adjustment in the 2008 standard mileage rate is part of a larger government attempt to offer taxpayers some relief from rapidly rising gas prices.

The Green Advantage

The residential green building market share is expected to almost double from 12% to 20% (\$40 billion to \$70 billion) of the market by 2012, according to research by McGraw-Hill Construction and the National Association of Home Builders.

The report also found that 40% of homebuilders believe that building homes using green materials and processes helps them market their homes in a down market.

Minimum Wage Increases

The federal minimum wage increased to \$6.55 per hour on July 24, 2008. It will increase again to \$7.25 per hour on July 24, 2009.

IRS Clamps Down on Fuel Tax Credit Scams

The fuel tax credit is on the IRS's radar screen. The agency has included unreasonable claims for the credit on its "Dirty Dozen" list of tax scams for 2008. ✓

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

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