

# PERSPECTIVES ON THE CONSTRUCTION INDUSTRY



**WebsterRogers** LLP  
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## New Tax Law Benefits Contractors

The recently enacted Economic Stimulus Act of 2008 (ESA) contains several provisions that are beneficial for contractors. In particular, ESA helps contractors that are planning to purchase equipment by raising the Section 179 expensing and investment limits. In addition, ESA provides for a bonus first-year allowance that will help contractors depreciate more of the cost of a business asset in the year it is placed in service.

### Increase in Section 179 Expensing

A contractor that buys machinery, equipment, trucks, and other qualifying assets can elect under Section 179 of the tax code to expense (deduct immediately, rather than depreciate over several years) the cost of the property purchased and placed in service during the tax year, up to a specified dollar limit. The maximum expensing amount is phased out, dollar-for-dollar, once the cost of the qualifying property placed in service during the tax year exceeds a specified amount. Moreover, the amount that can be expensed can't be greater than the taxpayer's taxable trade or business income.

ESA increases the limits applicable to the Section 179 expensing election for the 2008 tax year only. For property placed in service in tax years beginning in 2008, ESA raises the \$128,000 expensing limit to \$250,000. The overall investment

limit jumps from \$510,000 to \$800,000. As a result of these increases, many small and medium-sized contractors may be able to claim a deduction for the full cost of the equipment and machinery they place in service this year.

**Example:** M Paving Company, with 2008 taxable income of \$300,000 (not considering the expensing deduction), buys and

computing regular depreciation on the property. This additional deduction is generally available for property acquired after December 31, 2007, and before January 1, 2009.

**Example:** LJM Construction Corporation, a calendar-year taxpayer, bought \$1 million of machinery with a five-year life under the tax law's depreciation rules. Under the prior law, the first-year depreciation on the machinery would have been \$200,000 (20%). Thanks to ESA, LJM Construction can deduct first-year depreciation of \$600,000 (i.e., 50% of \$1 million bonus depreciation (\$500,000) plus 20% of the remaining \$500,000 adjusted basis (\$100,000)).

“ . . . ESA helps contractors that are planning to purchase equipment . . . . ”

places in service during the year new equipment costing \$220,000. Under the Economic Stimulus Act of 2008, the full \$220,000 purchase price of the equipment can be deducted for 2008 tax purposes.

### Bonus First-year Depreciation

The new law also provides another incentive for the purchase of business-related assets. Taxpayers can claim an additional first-year depreciation deduction equal to 50% of the adjusted basis of qualifying property (generally, new business property rather than real estate). The adjusted basis of the property is then reduced by the bonus depreciation when

### Call Us

The latest changes in the tax law may present opportunities for your firm. Please contact us to discuss your company's situation. ✓

### In This Issue . . .

Know When To Hold Them, Know When To Toss Them . . . . .	2
Building Better Banking Relationships . . . . .	3
Managing Overhead Costs . . . . .	3
Developments in Tax and Business . . . . .	4

# Know When To Hold Them, Know When To Toss Them

Collecting, collating, and storing business and tax records can often be time consuming and tedious. Still, it's an important task, one that contractors shouldn't ignore or postpone. Easily accessible, organized records can help simplify and streamline numerous aspects of your business dealings and can prove invaluable when disputes arise.

## Overview

Detailed records can help you handle audits or challenges from the IRS and state tax departments. During audits, the IRS may question certain deductions or credits your contracting firm has claimed. Producing the relevant paperwork that substantiates any deductions and credits you claimed is often all it takes to satisfy an IRS challenge.

In addition, good records can help your business in a variety of other situations.

retention of records. And don't forget that record retention requirements often are built into contracts.

## IRS Requirements

The IRS says that generally you must keep your records that support an item of income or deduction on a tax return until the period of limitations for that return runs out. The period of limitations is the period of time in which you can amend a tax return to claim a credit or refund, or that the IRS can assess additional tax. Years referenced below relate to the period after the return was filed. Returns filed before the due date are treated as filed on the due date. The periods of limitations that apply to income-tax returns are:

1. You owe additional tax and situations (2), (3), and (4) do not apply to you; *keep records for three years.*
2. You do not report income that you should report, and it is more than 25% of the gross income shown on your return; *keep records for six years.*
3. You file a fraudulent return; *keep records indefinitely.*
4. You do not file a return; *keep records indefinitely.*
5. You file a claim for credit or refund after you file your return; *keep records for three years from the date you filed your original return or two years from the date you paid the tax, whichever is later.*
6. You file a claim for a loss from worthless securities or a bad debt deduction; *keep records for seven years.*

7. Keep all employment tax records *for at least four years after the date that the tax becomes due or is paid, whichever is later.*

## Permanent Records

You will want to retain certain business records in permanent files. These include:

- ✓ Articles of incorporation
- ✓ Stock records and corporate minutes
- ✓ Deeds and mortgages
- ✓ Depreciation schedules
- ✓ Financial statements and audit reports
- ✓ General ledger and year-end trial balances
- ✓ Licenses and permits
- ✓ Copies of filed tax returns
- ✓ Tax and legal correspondence
- ✓ Contracts and leases
- ✓ Insurance records

## Other Records

It's generally a good idea to keep certain financial records for at least seven years (unless a longer retention period is required). These include:

- ✓ Sales records
- ✓ Expense reports
- ✓ Automobile logs
- ✓ Purchase orders
- ✓ Customer and vendor invoices
- ✓ Bank statements
- ✓ Accounts payable records
- ✓ Accounts receivable records
- ✓ Payroll records

You may be able to discard certain other items. Ask us for details. And remember, these are general rules of thumb. Check with the necessary government agencies and your attorney to determine the legal requirements that may apply to your contracting firm's business. ✓

**“Easily accessible, organized records can help simplify and streamline numerous aspects of your business dealings and can prove invaluable when disputes arise.”**

Employees or the Department of Labor could sue over disputed hourly rates or overtime payments. Other employees may charge discrimination relating to hiring and firing practices. Clearly, accurate and complete records can make the difference between winning and losing a dispute.

Federal acquisition regulations require contracting firms that participate in federal government contracts to retain various records for specific time periods. Details regarding these requirements are available online at [www.acquisition.gov/far](http://www.acquisition.gov/far). In addition, OSHA, the IRS, and various state and local building departments have a number of requirements regarding the

# Building Better Banking Relationships

How often do you communicate with your banker? Do you wait until it's time to renew your company's line of credit or apply for a new loan? If so, it may be time to take a fresh look at your banking relationship.

**“Stay in touch during tough times as well as during good times.”**

By talking to your banker regularly, you'll find out about bank products and services that could help your contracting business grow and develop. Your banker will get to know you personally and learn more about how you operate your business. Equally important, your banker can plug you into a fairly broad network of business contacts

that may turn into business opportunities for your company.

Keeping the lines of communication open and providing your banker with ongoing updates regarding your business activities and finances during good times and bad can go a long way toward helping you build a long-lasting relationship.

## Provide Regular Financial Updates

At a minimum, your banker will probably want to see your company's quarterly financial statements. However, you can go further than that by also providing interim updates on new contracts and long-term expansion plans.

High overhead expenses can be a red flag. Show your banker that your company is holding spending on selling, general, and administrative expenses to reasonable limits.

If your company carries more debt than other contractors of a similar size, you

may need to put spending plans on hold until you get your debt levels under control. Or consider leasing rather than buying new equipment. If you don't already do so, you may want to impose controls on overbillings and underbillings. Large overbillings may signal a potential cash flow squeeze in the future, while underbillings could indicate that your company is facing some problems on one or more jobs.

## Stay in Touch

Banks do not like surprises. Stay in touch during tough times as well as during good times. In general, most banks will try to help your business get past a difficult period if you keep them apprised of what's happening at all times. For example, update your banker if your company is suffering from a cash problem because of delayed payments or lower-than-anticipated margins on one or more jobs. It's at times like these that your efforts at cultivating a strong relationship with your banker will pay off. ✓

# Managing Overhead Costs

Close management of overhead costs is absolutely critical in today's business climate. Failure to track all costs and to allocate them to individual projects where appropriate makes it harder to measure profitability and to prepare accurate bids. By tracking and controlling overhead, you can maximize profits for your contracting firm and put your business in a stronger position to weather the current downturn in construction.

## Strategies for Managing Costs

Look for opportunities to assign costs to specific projects whenever possible. Your equipment costs — depreciation and the expense of operating a maintenance and repair facility — should be allocated to every job in which you use

your equipment. It will help you in the bidding process if you come up with an allocation rate that's based on the value of your equipment and then charge the cost of equipment to each job by the hour, day, or week.

Don't overlook the costs of sending managing personnel and estimators to inspect a job site or to talk with employees. By assigning the cost of their time on such visits to a specific job, you'll end up with a more accurate picture of your costs per job.

Indirect costs, such as corporate office expenses, staff salaries, office supplies, insurance, taxes, advertising, and marketing expenses, are generally easier to control and reduce than direct costs. Like most contractors, you likely can

identify ways that you can trim the costs associated with travel and entertainment expenses, expendable vehicles and equipment, temporary staff, and certain other administrative costs. ✓

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.

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## Developments in Tax and Business

### A Target-rich Environment

Could older Americans be the silver lining in an otherwise dark cloud for homebuilders? Some builders say "yes" and point to recent research by the National Association of Homebuilders, which reveals that individuals over age 55 now make up 20.9% of all new home buyers and 24.3% of new custom home buyers. Contractors who have enjoyed success by catering to this demographic say that the key is to develop products that will be attractive to the 55+ group. Typically, that means building in locations that are close to recreational activities and medical, restaurant, and retail facilities, where the amenities are provided by the community at large.

### Deduction for S Corp. Shareholders

When an S corporation picks up the cost of health coverage for a shareholder-employee who owns more than 2% of the corporation's outstanding stock, the shareholder must include the benefit in gross income. An offsetting "above-the-line" deduction is generally available to the shareholder on his or her personal return, which ultimately results in the benefit being income-tax free. However, in 2006, the IRS said that this favorable tax treatment isn't available to an individual who is an S corporation's sole shareholder and employee if the insurance is purchased in the *shareholder's* name. The IRS has now relaxed its position and will allow the above-the-line deduction. ✓

### Can We Serve You?

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

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