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Dimensions

A CPA's Report for the Construction Industry

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Subcontractor Prequalification

A Disciplined Approach to Vetting

Every construction project entails risk. If you're a general contractor, one of your greatest concerns is subcontractor risk, particularly if subcontractors perform the majority of the hands-on work on your projects.

Beyond outright failure to perform, subs can also expose GCs to other risks. These include jobsite safety and liability issues, liens from unpaid suppliers and the possibility of future warranty claims.

To help manage these risks, subcontractor prequalification is a recognized best practice among successful contractors. Unfortunately, it's also a practice that's often circumvented if a bid deadline is looming or there is significant price pressure on a project.

The Subcontractor's Perspective

If you are a subcontractor, you're probably eager to point out that project risk is not a one-way street. Subs are exposed to their own unique risks, which is why you should always conduct careful due diligence on both GCs and project owners before signing on to a project.

But bear in mind that an effective vetting process can actually serve your interests as well. Requiring subs to be prequalified could be considered one indicator of the general contractor's overall competence. In addition, as a well-managed sub, you can look on the prequalification process as another opportunity to set your company apart from less-qualified competitors.

Nevertheless, it's understandable that privately held subcontractors are sometimes reluctant to submit full financial statements or reveal other sensitive information. General contractors need to assure subs that the information will be reviewed by a limited number of people and then secured or destroyed.

Beyond the Financials

General contractors are sometimes tempted to be less attentive to subcontractor vetting on projects where subs are required to post performance bonds. But a performance bond can mitigate only some of the financial risk. A prudent contractor will augment a surety's investigation with additional research, double-checking bank and vendor references as well as the sub's reputation with other GCs.

Beyond financial information, a subcontractor prequalification should also evaluate other issues such as:

- *General experience:* Look for relevant experience in projects of comparable size and complexity.
- *Labor availability:* This is a growing concern in tight labor markets.
- *Equipment availability:* Pay particular attention to specialized equipment that is critical to the job schedule.
- *Safety record:* Examine OSHA data and establish an acceptable workers compensation experience modifier.
- *Insurance coverage:* Confirm that policies have adequate general and auto liability limits.
- *Upcoming jobs or backlog:* Verify that the sub is not becoming overextended.
- *Disputes or unresolved claims over previous jobs:* These are obvious red flags that could disqualify a sub altogether.

Disciplined – But Flexible

Whether you're implementing new vetting processes or simply reinvigorating a program that's been allowed to lapse, discipline is the key to a successful effort. But the program must also be flexible – that is, it should allow you to factor in certain variables.

These include the size and type of project, the project duration and how critical a particular subcontractor is to the overall project timeline. You might set more stringent standards for highly specialized trades, since

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Multistate Tax Requirements

Avoiding Compliance Issues

When your company takes on projects in more than one state, keeping up with various jurisdictions' tax and licensing requirements can be a challenge. Many states have become more aggressive in enforcing these requirements – which means many companies have found themselves facing unexpected penalties and interest because they inadvertently failed to comply.

Such problems can be avoided with a bit of planning and research. Here are some key areas to consider when expanding into a new jurisdiction.

Business Formation and Registration

A key early step is to confirm if there are special filing requirements for your form of business to be valid in the state. For example, some states do not automatically recognize federal Subchapter S Corporation status. You may need to file a separate state S Corporation election, or comply with special tax reporting requirements for qualified Subchapter S subsidiaries.

Your company will also need to be registered with the secretary of state in order to do business. This process often includes registering with the state department of revenue or taxation and with state payroll withholding and unemployment tax authorities. It may also involve establishing necessary sales or use tax accounts.

If you do not establish a physical office in the state, you may also be required to hire a registered agent within the state.

Professional Licensing and Permitting

Every state has specific construction industry licensing, bonding and insurance requirements that must be met. In most states, you will need to meet specific experience or examination requirements in order to be licensed, and your license application may need to be accompanied by a financial statement.

In addition, you will need to comply with the municipal and local permitting requirements that are specific to each project.

Employees and Payroll Taxes

Employees who live in one state and work in another are generally required to pay income tax to the state where they work. This means your company might need to set up an account to withhold taxes and submit them to the state where the work is done.

Some states have generous thresholds regarding how many days may be worked or how much income may be earned before withholding is required. But others require income tax withholding and reporting for as little as one day of work performed by an out-of-state employee.

Fortunately, many states have reciprocal agreements with neighboring states in which they agree not to impose income taxes on each other's residents. These can simplify things, but you must first verify that such an agreement is in place.

Income Taxes

The term "nexus" is used to describe a situation in which a business has a connection or presence in a state and is subject to that state's tax laws. Determining nexus for income tax purposes can be complex, and the portion of project income that is subject to income tax is not always clear-cut.

Sales, Use and Other Business Taxes

A designated product or service may be subject to state sales or use tax in one state but exempt in another. You will need to determine what constitutes nexus for sales and use tax purposes and identify what is taxable in each location where your company does business.

About half of all states impose a franchise tax, either in addition to an income tax or as a replacement for it. A franchise tax usually is not based on income but on net worth or capital held by the business. To further complicate matters, the nexus thresholds for income taxes and franchise taxes are not always the same.

Finally, many states and municipalities impose other types of business taxes such as margin taxes, commercial activities taxes and gross receipts taxes. It's important to understand the formulas that spell out what portion of your business will be subject to these taxes.

The financial benefits of an expanding business can be significant – but they can be severely diminished by tax or regulatory penalties. Careful research can help prevent these unnecessary costs.

Our firm can help you address multistate compliance issues. Please contact us for more information.

The Changing Jobsite

Seven Tech Trends to Watch

Over the past several decades, technological advances have revolutionized virtually every industry, including the construction industry. Where technology is going next is anyone's guess but if you're on the lookout for emerging trends, here are seven interesting technology-driven developments that industry observers are watching:

1. Jobsite imaging tools – Thermal imaging cameras, which measure the heat differential of objects, have many potential jobsite applications. For example, a thermal imager can be used to detect problem areas in an electrical panel, flaws in building insulation, roof leaks, plumbing blockages, and numerous other hidden problems that could cause warranty claims in the future.

2. Drones – Drones have been around for a few years now and costs have dropped considerably. In addition to offering better visibility for project status updates, drone technology can be combined with 3D modeling software to create interactive 3D site models that enhance design-build efficiency. One caveat: Some jurisdictions impose restrictions on drone use, so you should investigate first.

3. Robotics and automation – High-profile examples include brick-laying robots that can increase a mason's productivity by three times while reducing lifting by 80 percent. Other examples include automated lifting platforms and robot arms that lift heavy tools.

Jobsite automation can also help address the skilled worker shortage by attracting younger workers with an affinity for new technology.

4. Mobile apps – Time clocks and paper records are rapidly giving way to smart phone or tablet applications that track time and attendance automatically. In addition to eliminating manual data entry, mobile apps can link directly to payroll and streamline the tracking of job costs. Coupled with RFID chips, they can even track worker locations to help improve safety on hazardous sites.

5. Building information modeling (BIM) – BIM began appearing on jobsites during the 1990s and its use has grown rapidly since then. Creating a digital model of all project information allows architects, engineers and contractors to identify problems and conflicts in advance and call up digital images immediately on site.

At completion, project owners have a complete set of cross-referenced project information that helps them manage the property more efficiently.

6. Prefabrication – In addition to modular homes and tilt-up commercial structures, prefabrication is now being more widely used on other project types, including industrial and infrastructure projects. Fabricating modular components remotely under controlled conditions can enhance quality, increase productivity, reduce weather-related delays, and improve worker safety.

7. "Net zero" construction – Net zero buildings produce as much or more energy as they consume through the use of solar panels, wind turbines and other devices. In addition to possible tax benefits (such as R&D credits and Section 179d deductions), net zero technology can also help you deliver added value to the building owner by reducing the long-term cost of ownership.

Of course, any list of promising technology trends is virtually certain to be incomplete and almost immediately out of date. There are undoubtedly many other examples that could be listed.

What's more, today's advanced technology is likely to look crude and rudimentary when compared to what's coming. Anticipating this, some of the industry's largest companies have formed dedicated R&D teams that are responsible for identifying and researching new types of technology that could be applied by construction businesses.

Even if you can't afford a dedicated R&D team, it's wise to keep a close eye on technology trends and actively seek out new opportunities. Staying on top of coming advances can help your company be more productive, more competitive and ultimately more successful.

Vetting Subcontractors

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finding a replacement for a specialty subcontractor could be more difficult than replacing one of the more conventional trades.

Above all, an effective subcontractor prequalification program must be well thought-out, with clear rules and procedures. These should include rules about when exceptions can be made and who is authorized to make them.

If you have questions about subcontractor vetting or other related issues, please call us for an appointment.

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Don’t Overlook the Work Opportunity Tax Credit

As you search for ways to deal with the continuing skilled labor shortage, hiring inexperienced workers is probably your last resort. Hiring workers with no recent construction experience can drive up training costs and drive down productivity.

In some cases, though, the Work Opportunity Tax Credit (WOTC) might be available to help you offset some of those disadvantages.

The WOTC is a federal tax credit available to employers that hire individuals from nine target groups who traditionally face significant employment barriers. The credit could reduce your company’s federal income tax liability by $1,200 to $9,600 for each eligible employee, depending on the employee’s pay and hours worked.

There is no limit to the number of credits your company can claim, but employees must meet extensive qualification requirements in order to be considered a member of one of the following nine target groups:

1. Unemployed veterans (including disabled veterans)
2. Temporary Assistance for Needy Families (TANF) recipients
3. Supplemental Nutrition Assistance Program (SNAP) recipients
4. Residents of Urban Empowerment Zones or Rural Renewal counties
5. Individuals referred by approved vocational rehabilitation programs
6. Ex-felons
7. Supplemental Security Income (SSI) recipients
8. Summer Youth employees living in Empowerment Zones
9. Qualified recipients of long-term unemployment benefits

There are specific age limitations, time restrictions and other qualifications that differ considerably across the various target groups. The IRS and U.S. Department of Labor websites offer detailed information on the particular requirements for each group.

Before claiming the WOTC, you must obtain certification that the worker you hired qualifies for it. To do this, the employee must complete Form 8850, which you must file with the appropriate state workforce agency within 28 days after the employee starts work.