

Groundbreaking

construction news



Accounting and Financial News of Substance for the Construction Industry

12 Tax Strategies That Could Save Your Company Big Money

If you're a contractor looking for more ways to save your company money through basic deductions, deferrals, credits and other methods, then you've come to the right place.

Accounting Method Selection

There are two accounting methods to consider in the construction industry. The first is for long-term construction contracts and the second is for non-contract income and expenses. What we're going to explore in this section is 4 ways to save money by altering your accounting methods.

Note: Some method changes can be done automatically, while others require prior IRS approval.

10% Deferral Method

This method works best for large construction companies using the percentage-of-completion method (PCM). It is a one-time opportunity to defer the income from all contracts that are less than 10% complete. What's more, the income remains deferred until the contract in question is more than 10% complete.

Percentage-of-Completion Exceptions

For contractors using the PCM accounting method, there are two exceptions worth knowing about. The first is an exemption for any home construction contract (HCC). The second is an exemption on any construction contract that will be completed within 2 years for contractors with average annual gross receipts of less than \$10 million.

For contractors averaging more than \$10 million in gross receipts, the completed contract method (CCM) may still be used for home construction contracts. Contractors often elect to do this because the completed contract method usually gives the taxpayer a longer deferral than the percentage-of-completion method. However, it is important to note that once the owner accepts the job as 95% complete, the IRS views it as fully complete and all income must be recognized. This is where a little planning and reviewing your contract schedule early can come in handy.

12-Month Rule

Another way to save money is to deduct expenses as you pay them. As long as the taxpayer files the necessary accounting method change and has contracts that are 12 months or less, the taxpayer can take deductions for insurance contracts, as well as prepaid items like warranty contracts, maintenance contracts, software maintenance contracts, yellow page advertising and business licenses.

Defer Income & Accelerate Deductions

If, on the other hand, you're expecting a high-income year, deferring some of that income to later years, while accelerating your deductions, might be the way to go. For example, let's say your company operates on the cash method. One way to "reduce" your income for the year is to delay your billing invoices near the end of the year while paying as many expenses as possible.

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Beware the New Virginia Tax on Pass-Through Entities

In an attempt to raise additional revenue for the state, Virginia legislators have passed a new law requiring LLC and S corporations to withhold from nonresident owners 5% of all income generated in the state of Virginia.

A “nonresident owner” is any individual or corporation who cannot claim Virginia as their permanent place of residence. Entities with only Virginia resident owners will not be affected.

The new law, effective for all tax years beginning on or after January 1, 2008, presents a significant headache for not only the nonresident owner, but the Virginia pass-through entity itself.

For the Virginia pass-through entity, the new legislation requires it to withhold the 5% tax on all Virginia source income plus make extensive notifications to the nonresident owners. In addition, failure to perform the required duties could make the entity itself liable for the 5% tax. It is important to note that the withholding liability is based on allocated share of income and not distributions.

For the nonresident owner, this new legislation means they have 4 options:

1. Come to the state of Virginia to make a claim that the income is not properly taxable because nexus does not exist. To do so, a nonresident owner entity would need to prove that it does not have enough contacts in the state of Virginia to justify paying the Virginia tax per a recent ruling by the Richmond Circuit Court.
2. Get the Virginia pass-through entity to secure permission from all nonresident owners to file

a unified return on Form 765. (Note: The tax on Form 765 will be computed at the highest rate without the benefit of itemized deductions, standard deductions, personal exemptions, or credit for income taxes paid to state of residence.)

3. File the proper tax forms in the state of Virginia.
4. Decline to file the proper tax forms and forfeit the amounts withheld to the Commonwealth.

Certain withholding exemptions may apply for nonresident owners who are pass-through entities, diplomatic taxpayers, and corporations in particular industries, such as banking or tax exempt organizations that are exempt from federal income tax.

A pass-through entity requesting an exemption, however, must do so by providing a statement requesting such on a form provided by the Tax Commissioner. In this situation, the pass-through entity that has claimed the exemption will itself become responsible for paying the withholding tax on behalf of their nonresident owners.

Regardless of which path you may choose, it is important to note that the withholding is due on the due date of the tax return, regardless of any extensions you may have filed. The next due date is April 15, 2009.

Entities filing partnership and S Corporation returns should consider beginning the necessary withholdings now to ensure they will have sufficient funds to pay the liability later. This is especially important where significant sales of assets or liquidation of a business has occurred. □

Groundbreaking construction news ALERT!

Construction Related Tax Provisions in Bailout Bill

The Senate Finance Committee has issued a release in which it summarizes the tax provisions included in the Emergency Economic Stabilization Act of 2008. The following includes several provisions that should interest contractors:

- Qualified Energy Conservation Bonds
- Extension and Modification of Credit for Energy-Efficient Improvements to Existing Homes.
- Extension of Energy-Efficient Building Deduction.
- Extension of Credit for Energy-Efficient Improvements to New Homes
- Modification and Extension of Energy-Efficient Appliance Credit
- Accelerated Depreciation for Smart Meters and Smart Grid Systems
- Extension and Modification of Qualified Green Building and Sustainable Design Project Bond
- Investments in Recycling Equipment

Visit www.goodmanco.com/companyinfo/news/ for more detailed, up-to-date information regarding the bailout bill.

As the construction industry becomes more and more dependent on sophisticated software programs to ensure profitability contractor's CFOs like you seem to acquire more and more duties.

Not only do you need to be an expert in traditional accounting procedures, you also need to be able to track things like change orders and know where and how to further reduce the company's risks.

But wait, there is good news! Every year new software solutions are being developed to further integrate all of these duties under one information management system - one system that allows you to see at a glance what, where and how changes should be made or how the status quo should be kept the same.

And while each company has its own quirks and preferences for accounting and financial management, many of these software solutions can be used by all contractors, regardless of specialty.

Step 1: Process Mapping

As you might expect, the first step to investigating alternative IT solutions is knowing where you are. That means mapping out your current construction management and accounting processes.

Why? So you can understand exactly how your company makes its money and where there might be room for improvement. To do this, start by listing your company's top five or six most critical processes. This might involve asking questions like, "How is purchasing handled? How does estimating transfer a job to accounting? How are change orders entered?" and so on.

Once you have the processes mapped out, solicit input on how to improve them from key players like the owners, PMs, estimators, accounting personnel, etc.

Then sit down and identify how these processes might be better integrated. Also look for any gaps in your current system, as these will highlight other IT needs.

The important thing to remember in this step is not to get side-tracked by the "cool factor," i.e. putting really neat software features on your wish list that you don't need and won't ever use.

Step 2: Integrated Job Costing

Unlike other financial managers, CFOs often find

themselves in the unique position of being able to influence their company's profitability on a weekly or even daily basis.

How? By using software that not only tracks the standard accounting details like paying bills, staff and taxes but how these and other variables support job costing. Since almost every piece of data fed into a construction accounting software system ties back to a job, a CFO can easily see how things like production quantities, material costs, equipment hours, etc. are affecting job costs and company profits in real time.

What's more, the CFO can then report these numbers to the owner who can immediately begin taking measures to fix costly problems.

When evaluating your software options on this point, some questions worth asking include:

- How thoroughly does the software handle job costing?
- Can you accrue costs on a daily basis, including payroll data?
- Is it easy to enter various types of data such as production quantities, purchase orders, etc. from the field?
- Are job cost reports available in real time?

Ultimately, you want to find a solution that allows you to track real-time costs using single data entry that flows smoothly through the software, rather than requiring multiple workarounds or duplicate entries.

Step 3: Project Management

One of the biggest daily challenges CFOs face is getting up-to-date numbers from the project managers. Why? Because many of them still use paper spreadsheets or only log the data onto their personal laptops.

With the right software solution, however, this can be a problem of the past. Whether you opt for a stand-alone version or one that integrates with accounting, a centralized project management system is crucial to establishing a cohesive P&L picture and maintaining the CFO's peace of mind.

Step 4: Forensic Accounting

More often than not, the responsibility for supporting a job claim falls to the CFO and that's where a detailed paper trail can make the difference between easily winning a case or painfully losing one.

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If, however, you operate on an accrual basis, you could capture all current payables as expenses. For example, if you accrue for the last week of payroll, are you also accruing for related payroll expenses?

Another deduction worth considering comes from the bonuses and vacation time you pay out. These can be deducted in the current year, if they are paid within the first 2.5 months of the following tax year.

You cannot, however, accrue and deduct shareholder/partner expenses for tax purposes. They must be paid before the end of the tax year on the cash basis to get a deduction.

Yet another accrual option arises when your company contributes to a profit sharing plan. If you accrue the company's contribution at year-end, the company will have until the extended due date of its tax return, including extension, to make a deductible contribution for the previous tax year.

Depreciation & Fixed-Asset Management

By reviewing your fixed assets now, you can determine whether:

1. You can write off all old assets that have been abandoned
2. You can capitalize on losses that should be written off in the current year, or
3. You can take a loss for the remaining depreciable basis.

Other useful ideas include:

Section 179

As you may well know, Congress passed the Economic Stimulus Package Act of 2008 to boost the U.S. economy by giving tax rebates to individuals and tax incentives to businesses.

To further boost investments, the act increases the Section 179 limit for initial year expensing from \$128,000 to \$250,000. This means newly acquired assets can be deducted in one year, rather than being depreciated over a number of years.

But because this tax break was designed to primarily help smaller businesses, this dollar-for-dollar expensing option begins phasing out once total asset acquisitions for the tax year exceeds \$800,000 (formerly \$510,000).

This new limit applies for the calendar year of 2008 or a business' fiscal year beginning in 2008.

One thing that has not changed, however, is that businesses can only use this expensing election to offset net income. It cannot use this election to reduce net income below zero.

50% Depreciation Allowance

Yet another deduction worth looking into is the 50% deduction allowance. This is a special allowance for certain property generally acquired this year. To qualify, the special depreciation amount must be equal to 50% of its adjusted basis.

The following property types qualify:

- New tangible property with a recovery period of 20 years or less
- Computer software purchased by the business
- Water utility property
- Qualified leasehold improvement property

Like-Kind Exchanges

When it comes to equipment, this can be one of the biggest assets on a contractor's balance sheet. The question, however, is whether or not it makes more sense to sell a piece of equipment or trade it in.

What's important to note here is that a contractor can get the same benefits from a deferred like-kind exchange as with a straight trade-in. The difference is the like-kind exchange allows the contractor to sell their property outright for more money.

Under one scenario, this is accomplished by having a qualified intermediary receive the proceeds from the sale of the construction equipment. The contractor then uses those proceeds to purchase any type of construction equipment as replacement property, thus allowing the contractor to defer the gain from the sale.

Cost Segregation Studies

While most newly built, newly purchased or remodeled commercial real estate property must be depreciated over 39 years, there are exceptions as is the case with engineering-based and account-reviewed cost segregation.

Using this method, certain parts of the building and related costs can be depreciated over 5 or 7 years using 200% of the straight-line rate, or over 15 years using 150% of the straight-line rate.

Assets that typically qualify for this type of depreciation include decorative fixtures, cabinets, shelves, security equipment, parking lots, landscaping, and certain architectural fees.

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6 Steps to Choosing the Best Construction Software for Your Company

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Now most software providers understand the risks of construction and have built in various safeguards. The problem, however, arises when your company is called on to provide proof of a particular job's indirect costs. This might include things like small tools, cellular phones, drug testing expenses, etc.

Why is this a problem? Because most companies keep these expenses in a "pool," which is spread across all jobs at the end of the year. Unfortunately, disputes often require direct documentation indicating how you arrived at your indirect costs and spreading them out without a rational explanation could cost you a big chunk of your claim.

The best software will allow you to apply indirect costs in multiple ways.

Step 5: Reporting & Analysis

More important than the P&Ls, which are just a summary of the decisions the PMs and foremen make every day, are accurate reports of those daily decisions.

With that in mind, your most important reports will provide key performance indicators by answering questions like:

- Are daily production goals being met?
- Is equipment being used efficiently and charged to jobs accurately?
- Are phases of work being completed per schedule?

- Are project management documents being dealt with quickly?

If you can generate reports that answer these kinds of questions satisfactorily, you can uncover problems quicker, find solutions faster and save the company thousands of dollars in what would otherwise be lost revenue.

Step 6: Breaking Old Habits

This is quite possibly the most difficult aspect of implementing a new software solution. Like anything that has become routine or habit, creating new ones can be extremely difficult.

As an example, it's not uncommon for people to use Microsoft Excel as though it were the old-fashioned yellow tablet, rather than a computerized spreadsheet with immensely more functionality. So instead of improving their processes and increasing productivity, they just apply a new tool in the old way.

That's why it is important for the CFO and other key players to be willing to shift from a linear accounting mind-set to one that encompasses broader construction management practices in order for your new system to be successful.

So remember, when choosing a new software system, the goal is not to look for a short-term fix to a minor problem but a long-term solution for increasing your productivity and your bottom line. □

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Other Things to Consider

DPAD

Though it doesn't sound like it, the Domestic Production Activities Deduction (DPAD) is available to construction, engineering, and architectural businesses and will reduce the impact of income tax by 3% once it is fully implemented.

Until then, however, the DPAD is 6% of qualifying income for tax years 2007 through 2009 and jumps to 9% in 2010.

Of course the deduction does come with several planning challenges. For example, the deduction is limited to the lesser of Qualified Production Activities Income (QPAI) or current year taxable income. In this situation, QPAI is defined as new construction or substantial renovation performed in the U.S.

Write Off Bad Debts

The IRS treats bad business debts as ordinary losses that can be deducted when they become either partially or entirely worthless. The same may also be true for individuals and other entities

when loans made to closely held corporations are deemed "not related to business" and reclassified as partially or entirely worthless non-business bad debts.

Analyze Net Operating Losses

To create a cash infusion in your business, a net operating loss (NOL) can generally be carried back 2 years to get a cash refund.

If, on the other hand, your company experienced an unusually low marginal tax rate in the carryback years or if the AMT in prior years makes the carryback less beneficial, you can waive this option and carry the entire loss forward up to 20 years.

Fringe Benefits & Qualified Deferred Plans

Employers often benefit from providing fringe benefits to employees because they are not included in the employee's income, which gives the employer a deduction, and they usually avoid payroll taxes.

Also useful are qualified deferred plans because contractors get a tax deduction for their contributions and the employee gets a tax-deferred savings. □

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