CONTRACTOR

MAY/JUNE 2023

WOUCH MALONEY
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Midyear tax planning

DOCUMENT KEY DEDUCTIONS NOW TO LOWER NEXT YEAR'S BILL

For many businesses and individuals, tax season ended not too long ago. But for construction companies grappling with high costs and cash flow challenges, it's never too early to start thinking about how to lower next year's tax bill.

One way is to identify your most "claimable" deductions and ensure that you're collecting the necessary documentation as you work through the year. By doing so, you won't find yourself scrambling for substantiation when the tax-filing deadline begins to loom in 2024. Here are some of the most common types of deductions claimed by construction businesses.

Depreciation

Do you intend to buy some equipment, machinery or other types of capital assets this year? If so, you may be able to claim a depreciation-related deduction. For example, applicable to the 2023 tax year, you can claim first-year "bonus" depreciation equal to 80% of the cost of new and used eligible property placed in service before year-end.

There's also the Section 179 deduction. Technically, this is an *expensing* deduction rather than a depreciation one. Nonetheless, it's typically discussed in the context of depreciation. The Sec. 179 deduction allows you to deduct 100% of the purchase price of new and used eligible assets put in service this year.

Although the Sec. 179 deduction is capped at $1.16 million for 2023, and subject to other limits, there's no cap on bonus depreciation.

Tools and supplies

Tools and small equipment that you don't depreciate over time are generally deductible as expenses, whether leased or purchased. Drills, hammers, wheelbarrows and similar assets used for construction projects generally can be deducted in the year the expense incurred. The same rule applies to office supplies — from paper clips to sticky notes.

As you're likely aware, materials that you use on projects usually aren't deductible. You can't, for instance, deduct the cost of roofing shingles or aluminum siding. It's a good idea to keep a running list of deductible vs. nondeductible expenses to check purchases against during the year.

Energy-efficient construction

The Inflation Reduction Act, signed into law in 2022, made some significant changes to the Sec. 179D deduction for energy-efficient commercial buildings. One such change was increasing the potential value of the tax break and opening new qualification avenues for "designers" — which may include architecture and engineering firms as well as construction businesses.

Specifically, starting in 2023, the Sec. 179D deduction is worth up to $5 per square foot. And now all tax-exempt entities, not just governmental entities, can allocate their credits to designers.

CONTRACTORS CAN CLAIM THE RESEARCH CREDIT, TOO

The federal research credit — often referred to as the "research and development," "R&D" or Section 41 credit — is one of the most potentially valuable and often overlooked business tax breaks. And this includes for construction companies.

Eligible taxpayers can apply a percentage of their qualified research expenses (generally, 6% to 20%, including wages and supplies) to reduce their federal tax liability dollar for dollar. If you own a start-up or smaller construction business, you also might be able to apply the credit against your payroll tax liability. That means you can benefit even if you don't have income tax liability.

Many contractors mistakenly assume the research credit is available only to tech or research-based companies. But qualified activities include those related to construction, and your research efforts don't have to ultimately succeed to claim the tax break. Contact your CPA for further details.

To be eligible, you must create technical specifications for the installation of energy-efficient commercial building property. Simply installing, repairing or maintaining such property isn't sufficient to qualify. Your contracts should stipulate and clarify eligibility.

Advertising and marketing

Like most companies, construction businesses can generally deduct advertising and marketing costs, whether in traditional or digital media. This includes money spent on print media, billboards, directory listings, trade show exhibits, marketing materials and online ads.

You also can deduct the cost of advertising to fill empty positions. Many contractors have incurred such costs as they struggle with the skilled labor shortage. Keep records of your expenses for paid ads with an employment agency, in print publications or online.

Meals and employee events

The allowable deduction for business meals returns to 50% in 2023, after a temporary increase to 100% in 2021 and 2022. Food and beverage expenses must not be lavish or extravagant, and the taxpayer or an employee must be present.

Free food and beverages in break rooms or provided for the convenience of the employer, such as meals provided for employees who must stay on call for emergencies, also are subject to the applicable business meal limit.

However, certain meal-related expenses are 100% deductible. For example, typically, you can fully deduct expenses related to recreational, social or similar activities for staff, such as holiday parties, as long as the activities don't favor highly compensated employees.

Employee training

For contractors, employee training has become more important than ever. Regular, comprehensive safety courses can help control workers' compensation costs, keep your crews fully staffed and prevent project delays.

The good news is that costs for formal training are generally deductible — assuming you can substantiate them. This may include training you provide or pay for so employees can obtain more advanced qualifications and certifications. You might even be able to claim the cost of informal training, such as daily "toolbox talks," to reach the maximum allowable deduction.

Stay on top of it

Tax-savvy construction companies carefully track their deduction-related costs throughout the year. Your CPA can help you establish the necessary policies and procedures to properly document expenses and reduce tax liability. ■

PERUSING PIP CLAUSES ARE IN EVERY CONTRACTOR'S BEST INTEREST

At one time or another, you may have encountered the expression "don't hate the player, hate the game." Part of the construction game that has given rise to much conflict and consternation over the years is pay-if-paid (PIP) clauses in contracts.

How you view this language likely depends on whether you're a general contractor or a subcontractor. Whatever the case may be, it's in every construction company owner's best interest to know the finer points of PIP clauses in the states where you operate.

Enforceability of the clause

In legal terms, a PIP clause provides that the general contractor isn't obligated to pay the subcontractor unless and until the owner pays the general contractor.

In most states, courts enforce PIP clauses if they explicitly provide that receipt of payment from the owner is a condition precedent to the general contractor's obligation to pay the sub. One reason for this is the view that shifting the risk of nonpayment to a subcontractor is a harsh result that should be imposed only if the language of the contract is clear and unambiguous.

To help ensure that PIP clauses are enforceable, general contractors should use the term "condition precedent" in their contracts. It's also a good idea to include language to the effect that the subcontractor expressly assumes the risk of nonpayment by the owner.

Be aware, however, that even properly drafted PIP clauses may be unenforceable. In years past, some state courts have held that PIP clauses violate public policy by forcing subs to waive their statutory mechanics' lien rights. A number of states have passed laws banning or limiting the use of PIP provisions.

Even in states where PIP clauses are enforceable, the language can be invalidated if the general contractor improperly causes the owner to withhold payment — for example, by breaching its contract with the owner.

Bonding perspective

If an enforceable PIP clause prevents a subcontractor from collecting from the general contractor, can the sub still make a claim against the general contractor's payment bond? Here, again, the outcome has historically varied from state to state.

In some states, the courts have allowed sureties to assert a PIP clause as a defense against a subcontractor claim. These courts followed the general rule that a surety "stands in the shoes" of the general contractor and was able to avail itself of the general contractor's contractual defenses.

Make sure PIP clauses are drafted carefully to make your intentions crystal clear.

In other states, courts have held that extending the protection of a PIP clause to a surety would defeat the purpose of a payment bond, which is to ensure payment of subs and suppliers in the event the general contractor doesn't pay.

Actions to consider

If you're a general contractor and wish to secure the protection of a PIP clause, review the applicable law for each state in which you do business. For contracts governed by states that permit PIP clauses, make sure the clauses are drafted carefully to make your intentions crystal clear.

If you're a subcontractor being asked to sign a contract that contains a PIP clause, understand and evaluate the risks involved — and then price your services accordingly. Also, consider including similar provisions in your contracts with sub-subcontractors and suppliers, so you're not obligated to pay them unless and until the general contractor pays you.

Finally, look carefully at whether a contract includes a PIP clause or a paid *when* paid (PWP) clause. Under a PWP clause, the general contractor must pay the sub within a specified time (seven days, for example) after receiving payment from the owner.

An ongoing matter

As mentioned up top, one's perspective on PIP clauses tends to vary depending on whether you're a general contractor or subcontractor. And the legal ramifications of this contract language could change along with state laws and court decisions. If you have concerns, discuss the matter with your attorney and work with your CPA to manage the financial implications. ■

UH OH, WHERE DID MY PROFITS GO?

Most contractors have been there. A construction project is well planned, with all the i's dotted and t's crossed. Yet, as the weeks go by, higher than anticipated expenses gradually cause the job's profit margin to vanish into thin air.

This pernicious problem is commonly known as "profit fade," and it's becoming increasingly likely

in today's world of rising materials costs, scarce labor and sluggish supply chains. Fortunately, there are ways to fight back.

Refine your estimating process

Most project losses can be traced back to less-than-optimal estimates, which in turn lead to inefficient bids. Review a set of your most recent estimates. Are they adequately detailed? Do they account for *all* the costs that ended up being associated with the given job?

Also determine whether your estimators have enough training and experience to perform at their best in the current inflationary environment. Are they being realistic about the existing price points for labor, materials and equipment usage?

Use cost codes

If you haven't already, explore the benefits of assigning cost codes to every task typically associated with your jobs. Think of them as tiny price tags attached to each activity that allow you to see how much that task costs.

Establishing a sound cost code structure and using it consistently companywide — from estimators to project managers to accounting staff — is key to getting useful data. Over time, and with a solid sample size of projects, you'll be able to determine which activities cost the most and which ones are costing too much.

Review contract language

Well-defined contract terms and conditions are another way to minimize the potential for profit fade. Contract language should clearly define the nature and scope of the work to be performed. If possible, include a clause that limits how much, if anything, an owner can change while work is in progress before paying additional compensation under a formal change order process. From there, lay out straightforward steps for submissions and approvals of change orders so you can bill for additional work as soon as possible.

Additionally, explore the feasibility of including a price acceleration clause that allows you to adjust the contract price if materials or labor costs rise above a stated level. To add another layer of protection, you could ask for a deposit to buy and store materials before work begins.

Double down on materials management

Indeed, the skyrocketing cost of materials is arguably the chief culprit of profit fade these days. When bidding on a project, create a contingency plan of two or more alternative suppliers. Preferably, at least one of them should be local so you can get deliveries relatively quickly.

If possible, build up inventory levels with critical materials and long-lead items to insulate your company against supply chain slowdowns. Bear in mind that this will entail a substantial upfront investment and the capacity to safely store the items.

Strategize for success

Profit fade has always been an issue for construction companies. But, unfortunately, it's a problem whose "time has come" as inflation continues to concern economists and business owners alike worldwide. Work with your financial advisors to gather data and devise strategies to protect your business. ■

7 SOCIAL MEDIA TIPS FOR CONSTRUCTION COMPANIES

Construction businesses can no longer ignore the far-reaching power of social media. The most widely used platforms give contractors direct access to potential customers, partners, investors and job candidates. Here are seven tips for social media success:

1. Choose the right channels. Select platforms based on your target audience. Generally, LinkedIn is best for connecting with industry peers. Facebook and Twitter tend to reach more general and typically older audiences. Instagram and TikTok skew younger, but creating content for them can be trickier.

2. Post multiple times a week. According to a survey of social media marketers by inbound marketing software provider HubSpot, the best times to post across all industries and platforms are between 12 p.m. and 3 p.m. and 6 p.m. and 9 p.m. Although you should post at least several times weekly, the best day to do so is Friday.

3. Use a consistent tone that fits your brand. Decide in advance what you want to share and how. Do you want to be casual and funny? More formal and informative? Stick to your construction company's core values and culture. Refrain from negativity and avoid polarizing topics such as politics and religion.

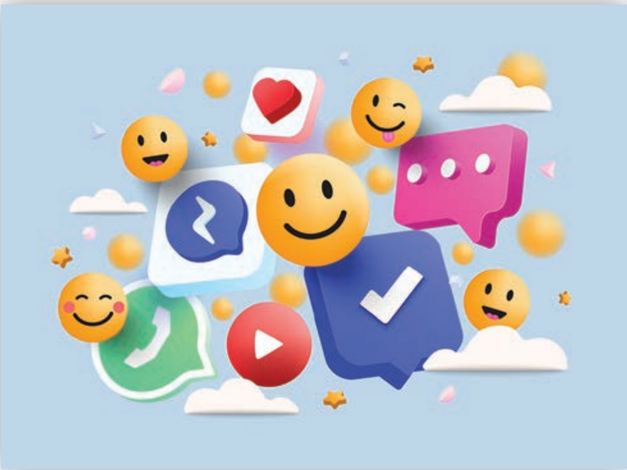
4. Be authentic. Show the human side of your business. Spotlight key employees. Celebrate milestones, such as service anniversaries and birthdays. Provide updates on notable projects (with the owner's permission). Give a shout-out to valued partners. Show highlights from community events that your business participates in — for example, baseball games and parades.

5. Get a feel for video. Studies tend to show that videos make the most impact on social media. Of course, most contractors don't moonlight as cinematographers. But do the best you can, making sure that whatever you post doesn't reflect negatively on the business.

Consider posting "pro tips" about simple repairs or maintenance. Take short behind-the-scenes clips on the jobsite or in the office. Create a time-lapse video of a project from start to finish (again, assuming the owner doesn't mind). If you use a drone, show a bird's-eye view of your work.

6. Be a community member. To truly succeed at social media, you must play both sides of the game. Follow industry influencers, associations, trade publications and fellow contractors. Share and comment on posts and articles of interest.

7. Engage, engage, engage! If a question is asked, answer it. If a compliment is given, say thanks. If a complaint is made … be careful. For valid grievances, respond with empathy and ask for further information, if necessary. It's generally best to solve disputes privately. In the case of trolling or irrational online behavior, the most advisable move is to either not respond or flatly state company policy. Avoid heated arguments and block repeat offenders. ■



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About Wouch, Maloney & Co., LLP

Wouch, Maloney & Co., LLP is a regional certified public accounting firm with offices in Horsham and Philadelphia, Pennsylvania and Bonita Springs, Florida. The firm has provided closely held business and individual clients with a wide array of accounting services for over 30 years. Wouch, Maloney & Co.'s domestic, multi-state and international clients reflect a broad range of industries from real estate and construction to manufacturing, wholesale and professional service. The firm offers a comprehensive group of services including tax, audit and accounting, business consulting, estate planning, business valuation, litigation support and forensic accounting.

Serving the Construction Industry

Wouch, Maloney & Co., LLP prides itself on its niche practice in the construction industry. The majority of our clients are involved in construction and we are adept at recognizing and solving problems common to that industry. For over thirty years, we have represented contractors along with commercial and home builders in Pennsylvania, New Jersey and Florida.

- We develop **relationships with lenders and bonding agents** and understand how to present your financial picture in their preferred format.
- We assist you in **keeping a close eye on debt, cash flow, profit margins** and other measures of financial health.
- We prepare **contracts in progress** schedules that management can understand which clearly illustrate gross profit, job costing and over/under billings per job.
- We have highly trained staff with **expertise in construction accounting** who are detail oriented, but who do not lose sight of the larger goal which is to provide our clients with quality services to meet their many financial needs.

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