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Worker misclassification

Construction companies remain at risk for penalties

Set the tone for strong cash flow this year

Using the H-2B visa program to fill labor gaps

What's the deal with subcontractor bonding?

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Worker misclassification

CONSTRUCTION COMPANIES REMAIN AT RISK FOR PENALTIES

It's been nearly 10 years since the McClatchy Media Network published a series of articles in its News & Observer newspaper on the allegedly widespread practice of construction businesses misclassifying construction laborers as independent contractors rather than employees.

Since then, a shortage of skilled labor — or any labor in some instances — has persisted in many markets. If your construction business sometimes turns to independent contractors to fill certain roles on projects, it's critical to know the rules.

A lingering issue

The 2014 McClatchy articles focused in part on how the 2009 stimulus package inadvertently incentivized construction companies to misclassify workers as independent contractors to cut costs and win publicly funded projects. Those incentives are no longer in place; however, other ones — such as those offered under the Infrastructure Investment and Jobs Act — have replaced them. So, the motivation to cut employment costs by engaging independent contractors rather than hiring employees remains.

When workers are independent contractors, they aren't covered by the Fair Labor Standards Act or other federal and state mandated protections regarding things such as workers' compensation, unemployment insurance and Occupational Safety and Health Administration mandates. What's more, employers don't have to pay payroll taxes on independent contractors' compensation nor provide those individuals with fringe benefits.

The problem arises when employers engage independent contractors but treat them like employees. The potential cost of *misclassifying* employees in this manner is high. In 2023, for example, the U.S. Department of Labor (DOL) announced that it had recovered more than $1.6 million in back wages and liquidated damages for nearly 200 construction services workers in North Carolina. They'd been denied overtime and minimum wages by a construction services company that misclassified them as independent contractors.

Current DOL test

The DOL's "final rule" for determining whether a worker is an independent contractor or an employee has changed several times. The rule in place as of this writing was developed under the Trump administration and is considered more employer-friendly than the one used during the Obama administration.

The current final rule focuses primarily on whether, as an "economic reality," workers are dependent on the employer for work (making them employees) or are in business for themselves (defining them as independent contractors). It evaluates five factors, with no single factor controlling. Courts and the DOL had previously applied five or more overlapping factors, treating the economic reality test as a "totality-of-the-circumstances" test.

The "core factors" of the current rule are the nature and degree of the employer's control over the work, and the worker's opportunity for profit and

THE IRS TEST

The IRS has its own test for determining whether a worker is an independent contractor or employee for tax purposes. The agency considers three categories of facts:

1. Behavioral. These are factors that indicate whether an employer has the right to direct or control how the worker performs tasks, regardless of whether the employer actually does so. Instructions, training and performance evaluations indicate the right exists.

2. Financial. A worker is likely to be an independent contractor if the person incurs significant unreimbursed expenses, has a major investment in business activities as an independent contractor, provides the tools or supplies for the job, and is available to work for other clients. Method of payment matters, too. Independent contractors usually are paid a flat fee, while employees generally are guaranteed a regular wage amount.

3. Type of relationship. How do the worker and employer mutually perceive their relationship? Evidence can include written contracts, benefits, permanency of the relationship and whether the services provided are a key activity of the employer's business.

loss. If both factors suggest the same classification, it's substantially likely that the classification is proper. Additional noncore factors include:

- The amount of skill required for the work,
- The degree of permanence of the working relationship between the worker and employer, and
- Whether the work is part of an integrated unit of production.

The regulations state, however, that these factors are "highly unlikely" to outweigh the combined weight of the core factors if the core factors indicate the same classification.

Proposed final rule

The Biden administration has made moves to rescind the Trump administration's final rule. In October 2022, the DOL proposed a new rule that would bring back a totality-of-the-circumstances evaluation that considers all factors. That is, it wouldn't give the core factors greater weight than the others. The proposed rule also would resurrect consideration of whether the work performed is central or important to the employer's business. The current rule doesn't consider this factor.

Under the proposed final rule, the DOL would continue to place great weight on economic dependence. The proposed rule emphasizes that economic dependence doesn't depend on the amount the worker earns or whether the worker has other sources of income. Rather, the relevant factors would be:

1. The worker's opportunity for profit or loss depending on managerial skill (as opposed to just deciding to take more jobs or work more hours),
2. Investments by the worker and employer,
3. The degree of permanence of the work relationship,
4. The nature and degree of control,
5. The extent to which the work is an integral part of the employer's business, and
6. The skill and initiative required for the work.

The DOL's comment period for the proposed rule closed in December 2022, with more than 55,000 comments submitted.

Latest developments

Again, as of this writing, the Trump administration's final rule was still in place, but the Biden administration's revised rule appeared imminent. Consult your employment law attorney and CPA for the latest developments. ■

SET THE TONE FOR STRONG CASH FLOW THIS YEAR

A fresh calendar year has arrived for construction businesses, offering both challenges and opportunities. Many factors will affect your company's success this year — including inflation, the availability of labor and materials, and just how many projects you're able to add to your backlog. Through it all, one thing that always matters is cash flow. Here are some ways to set the tone for maintaining strong cash flow throughout the year.

Use projections consistently

Many construction companies get into trouble because a sudden cash-flow slowdown catches them by surprise. To prevent this, perform regular cash-flow projections to stay informed of where you stand. Such projections can also enable you to pinpoint precisely which types of jobs best suit your business in terms of profitability.

Generating cash-flow projections involves looking at both the past and future. Examine your projects scheduled for the next year and outline when and how you'll likely spend money. Bearing in mind that things could change, lay out expected monthly revenue for each job. Don't overlook overhead and indirect costs (that is, costs that apply to more than one project).

To prevent unpleasant surprises, perform regular cash-flow projections to stay informed of where you stand.

In cases where you're doing a job for a new owner or planning a project on spec, you may encounter difficulties predicting the timing. But you can use historical payment data to calculate an average for planning purposes. This same data, accumulated over time, also can give you an idea of how quickly certain owners pay their bills.

Always be mindful that, for construction businesses, working capital (a financial measure of liquidity) tends to ebb and flow based on the distinctive nature of the industry. You're no doubt familiar with the situation: Your company generally doesn't get paid until a job or job phase is completed, yet you still need to pay labor, equipment and materials costs currently. On the bright side, assuming you're a general contractor, you typically don't need

to pay subcontractors until your company collects from the owner.

Manage jobs for positive cash flow

There are many aspects of a project that can hurt your cash flow — or help it. Take change orders. If you devise a better system for getting them approved, you'll get paid more quickly for the additional work, bring in that revenue and thereby strengthen cash flow. Try to get a feel during contract negotiations as to how easily you'll be able to work with owners on change orders if they arise.

There's also the issue of billing. You obviously don't want to underbill. However, when done judiciously and within the rules, overbilling (charging before a job or job phase is completed) can benefit cash flow. Doing so calls for a disciplined approach to completing work and strong cash management skills.

Above all, ensure your billing and collections procedures are as fast and efficient as possible. Establish strong follow-up procedures for handling slow payors and appropriately aggressive measures for collecting receivables.

Buy assets and materials carefully

Cash-flow surprises can often spring from a haphazard approach to asset management and materials purchases. When it comes to heavy equipment, contemplate the "buy vs. lease" conundrum carefully. It's generally preferable to pay for assets you're going to own for an extended period over that very period and save your cash for other, more immediate purposes. Leasing may offer lower payments and less risk in terms of obsolescence.

Also keep an eye on inventory. Keeping materials on hand may keep jobs running smoothly, but buying too much can weaken cash flow, and you've got to be able to store it safely. Plan orders so you can keep just enough inventory without jeopardizing project timeliness.

Recognize the risk

Cash-flow trouble is an equal opportunity threat. It can seriously endanger a struggling construction business, but even a successful one can face major risk if it overcommits to projects without the liquidity to support them. Work with your CPA to monitor the right metrics and set wise spending policies. ■

USING THE H-2B VISA PROGRAM TO FILL LABOR GAPS

With the construction industry battling a long-running skilled labor shortage, contractors may need to explore every avenue available to find workers. One option to carefully consider is the federal H-2B guest worker visa program.

Temporary need

The H-2B visa program permits U.S. employers to temporarily hire foreign nationals for full-time, nonagricultural jobs when they can't find enough American job seekers willing to do the work. Under immigration law, "temporary need" employment generally means a job lasting one year or less. However, employers may apply for extensions of up to one year at a time. The maximum period of consecutive stay for a person holding H-2B classification is three years.

Currently, the United States grants up to 66,000 H-2B visas per fiscal year — up to 33,000 for workers who begin employment during the first half (October 1 to March 31) and 33,000 for those who begin employment during the second half (April 1 to September 30). Any unused visas from

the first half are made available to employers seeking to hire H-2B workers during the second.

How to apply

To qualify for H-2B nonimmigrant classification, an employer must first apply for U.S. Department of Labor (DOL) temporary labor certification (TLC). This is usually done through a local or state workforce agency.

With a TLC in hand, the employer can submit the visa petition — Form I-129, "Petition for a Nonimmigrant Worker" — with U.S. Citizenship and Immigration Services on a prospective worker's behalf. The forms must be carefully filled out to establish:

- There aren't enough qualified U.S. workers available to perform the temporary work,
- Employing H-2B workers won't adversely affect the wages and working conditions of similarly employed U.S. workers, and
- The need for labor is temporary.

That last point means the employment situation is either a one-time occurrence (of short duration), seasonal (tied to a season of the year by a recurring event or pattern), a peak-load need that requires a temporary supplement of workers, or an intermittent (occasional) need for services or labor over short periods.

Employers also must provide inbound transportation and subsistence costs (lodging incurred on the employer's behalf and meals).

Once applications are approved and job offers extended, prospective workers located outside the United States must apply for an H-2B visa with the U.S. Department of State at a U.S. Embassy or Consulate.

Costs and wages

The Form I-129 filing fee is $460. In addition, the employer must pay H-2B workers' visa-related and

border crossing costs either in advance, directly or through reimbursement in the first workweek, according to a fact sheet issued by the DOL. Employers also must provide inbound transportation and subsistence costs (lodging incurred on the employer's behalf and meals).

H-2B and U.S. workers employed in corresponding jobs must be paid no less than the wage rate specified in the job order. This rate must be at least the highest of the prevailing wage rate obtained by the DOL's Employment and Training Administration or the applicable minimum wage under federal, state or local law.

Be careful

Consult with a legal advisor when filling out the forms and managing the workers in question. Just last year, the DOL obtained a consent order for the recovery of more than $317,000 in back wages from a Pennsylvania subcontractor for H-2B guest worker violations. Nonetheless, under the right circumstances, the program can offer a way to strategically augment your workforce. ■

WHAT'S THE DEAL WITH SUBCONTRACTOR BONDING?

When taking on large or complex projects, most general contractors would likely agree that bringing in the right subcontractors is key. Unfortunately, even the most carefully chosen subcontractor can fail to live up to expectations. That's why general contractors should know under what circumstances they need to require a subcontractor to obtain a surety bond.

Incentives and peace of mind

A subcontractor bond is a project-specific agreement between the general contractor, subcontractor and surety (a third-party guarantor) that's often, but not always, required under the contract. There are generally two types of such bonds:

- A *payment* bond holds the bonded subcontractor liable for payments they owe to their own subcontractors and suppliers, and
- A *performance* bond holds the subcontractor (principal) liable for damages caused to the general contractor (the obligee) by performance issues and default.

Performance bonds tend to be more common. Under this type of agreement, if a subcontractor does substandard work or cannot complete a project, the surety will step in and either help the subcontractor complete the project or find another company to finish the job. In either case, the subcontractor must pay back the surety for the associated costs. This creates a strong incentive to meet the contract's performance standards.

Requiring a subcontractor to be bonded also brings peace of mind that the surety will do a thorough job vetting the company before issuing the bond. Sureties assess the same three qualities in subcontractors as they do in general contractors: capacity (ability to complete the job), capital (financial stability) and character (trustworthy leadership and staff).

Reasons to require

In some cases, a general contractor's decision of whether to require a subcontractor to obtain a bond is easy. State or local laws may mandate that all construction companies working on certain types of projects be bonded. Many publicly funded projects — federal, state and local — also require bonding across the board. There's even a general rule of thumb that says if a subcontract exceeds $100,000 in value, the subcontractor should get bonded.

Other times, a general contractor may have more subjective reasons for requiring a subcontractor to obtain a bond. These include when a subcontractor provides specialized skills or expertise that can't easily be replaced, or when a subcontractor plays a particularly critical role in completing a project. Sometimes it makes sense to ask a brand new or largely unknown subcontractor to obtain bonding.

No surprises

Surety bonds can help all parties to a construction contract manage risk. Whether you're a general contractor or subcontractor, be sure you're familiar with the bonding process so you're not caught off guard by the need to require or obtain a bond. ■

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