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4 major payroll challenges for construction companies

Payroll complexity is just one of the reasons why running a construction business differs from managing other types of companies. Let's review four major payroll challenges you and your leadership team likely already face and how to address them.

1. Worker classification

Properly classifying workers as employees or independent contractors is sometimes tricky for construction companies. However, doing so is critical to issues such as calculating payroll tax and determining eligibility for minimum wages, overtime pay and fringe benefits. Mistakes can be costly. (See "The high price of employee misclassification" on page 3.)

Over the past decade, various presidential administrations have modified the U.S. Department of Labor's (DOL's) regulations for determining whether a worker is an employee or independent contractor under the Fair Labor Standards Act. And that could happen again. To worsen matters, the IRS applies a different test than the DOL.

If you haven't done so recently, meet with your professional advisors to double-check how your construction business differentiates between employees and independent contractors. Be sure you're keeping accurate documentation for each worker of factors such as:

- Job duties,
- Payment methods, and
- Your degree of control over the worker's schedule and activities (regardless of whether you exercise it).

Regularly verify that your employee classifications comply with the latest regulations. Meanwhile, ensure your human resources and payroll teams are current on IRS and DOL guidelines.

2. Overtime and other regulatory requirements

The test for overtime pay eligibility has also been revised in recent years, and yet another round of changes is possible under the second Trump administration. Moreover, you must stay current with state and local regulations. These may include regs for locations where:

- Your workers legally reside,
- You have projects, and
- Your company is based.

State and local rules can be more stringent than federal ones in areas such as overtime, minimum wage, meal and rest breaks, and leave requirements. Plus, states may have their own additional income and payroll taxes and, in turn, withholding and reporting requirements.

Consider creating a compliance matrix outlining payroll regs for every state and locality where your business operates. Additionally, be sure that your payroll software can apply location-specific rules when processing wages — if it can't, you might want to upgrade.

3. Prevailing wage compliance

Under the Davis-Bacon Act of 1931, the federal government established a requirement that contractors pay local prevailing wages to laborers and mechanics when working on public works projects. (State or local laws may also apply.) Prevailing wage rates vary by project, job duties and location, so monitor them carefully.

Accurate documentation is key here, too. Keep detailed and ongoing records of hours worked (divided between regular and overtime), wages and benefits paid, labor classifications, projects worked on, and payroll deductions. This information is required for weekly certified payroll reporting. Payroll records generally serve as the basis for such reports. If those contain errors, the certified payroll reports will also be inaccurate.

And you need to do more than accurately report the required information. You must format the data correctly and meet strict submission deadlines. Errors or omissions can lead to fines and the loss of eligibility for future public projects. Again, your payroll software should be able to help you automate and standardize your reporting.

4. Varying pay rates

Payroll for many types of businesses is relatively simple because most employee groups are compensated at a single regular pay rate. Even if overtime is involved, the calculation is just 1.5 times the regular rate.

However, a construction worker's pay rate can vary by location, project, task or equipment used. For example, a worker could spend the morning using a forklift and the afternoon operating a crane tower. Because that second piece of equipment calls for greater skill and carries more risk, the operator will be compensated at a higher pay rate. Further, the rates for both types of work might vary in different locations because of prevailing wage requirements, union rules or labor availability.

Train project managers or crew supervisors to log labor classifications and job changes in real time. Reinforce the importance of doing so as part of performance management. In addition, use up-to-date software to integrate time tracking and job costing into your payroll system.

No surprises

If your construction company has been in business for a while, you're probably familiar with all four of these challenges. Nonetheless, keep your payroll processes sharp and look for ways to improve them continuously. ■

The high price of employee misclassification

Recently, a national construction business learned the hard way about the high price of misclassifying employees as independent contractors. The Office of the Attorney General of the District of Columbia filed a lawsuit alleging the company, its general contractor and multiple labor brokers misclassified hundreds of workers to avoid paid sick leave and payroll taxes.

Under a settlement reached in July 2024 with the Attorney General, the construction business must pay $3.75 million, including:

- More than $1.7 million in worker restitution,
- More than $1.1 million in civil penalties, and
- $880,000 in attorneys' fees.

Additionally, the defendants must overhaul their payroll and contracting practices to prevent future employee misclassification. The construction company was also required to submit certified reports to the Attorney General for three years to demonstrate compliance with the settlement terms and Washington, D.C., law. Last, it had to agree to stop working with labor brokers that have misclassified workers or failed to provide paid sick leave to properly classified workers.

Pondering the possibility of sale-leaseback financing

The construction industry is characterized by intense cash flow challenges. Generally, construction companies don't get paid until a project or job phase is completed — and subcontractors may have to wait even longer.

As a result, there may be times when you need a quick cash infusion and don't want to deal with the lengthy approval process of a business loan. One possible solution is sale-leaseback financing involving one or more pieces of your construction equipment.

Consider the upsides

Under a sale-leaseback financing agreement, your construction company sells an asset and then leases it back from the buyer. Selling the asset can give you up to 100% of its cash value. Moreover, you make no immediate sacrifice. You still get to use the equipment, and the added cash flow from the sale may help you pay down debt, buy supplies, upgrade remaining assets or simply improve liquidity.

Besides obtaining a quick influx of cash, contractors have other reasons to choose sale-leaseback financing over retaining ownership, signing a standard lease or taking out a loan. For example, sale-leasebacks are typically less restrictive than other types of financing. And one of these arrangements can be structured as a taxable sale under IRS rules, potentially allowing you to offset the sale gain with other deductions to help reduce future tax obligations.

Regarding revenue recognition, if the arrangement qualifies as financing and not an outright sale, income is recognized over the lease term. This can help you manage taxable income.

Additionally, lease payments made on the sold equipment may be tax deductible, provided the lease is treated as an operating lease under IRS guidelines. These include the stipulation that the buyer transfers to the seller only the right to use the property without transferring ownership rights.

Watch out for potential downsides

One major disadvantage of sale-leaseback financing is the loss of flexibility associated with ownership, including your freedom to modify the asset. Also, typically, you won't resume ownership at the end of the lease term unless the sale-leaseback agreement includes a repurchase option.

However, including a repurchase option may create accounting complexities. That's because, under U.S. Generally Accepted Accounting Principles (GAAP), the arrangement will qualify as a finance lease rather than an operating lease if any of the following apply:

- The lease transfers ownership of the asset to the lessee by the end of the lease term,
- The lease grants the lessee an option to buy the asset that the lessee is reasonably sure to exercise,
- The lease term is for the "major part" of the asset's remaining economic life,

- The present value of lease payments substantially equals or exceeds the asset's fair value, or
- The asset is of such a specialized nature that it's expected to have no alternative use for the lessor at the end of the lease term.

If a leaseback is indeed classified as a finance lease, it must be treated as if no sale has occurred and accounted for as a failed sale-leaseback. Without a repurchase option, your sale-leaseback will likely be classified as an operating lease, with interest and amortization combined as a single, straight-line expense over the lease term.

In summary, a lease's characterization affects the timing and presentation of expense recognition. This may, in turn, affect certain financial ratios and operating metrics — such as earnings before interest, taxes, depreciation and amortization (commonly referred to as EBITDA) — that sureties, lenders and investors monitor.

Important: A lease's *tax* characterization may not necessarily follow its *GAAP* characterization. The differing treatments tend to complicate tax and financial reporting.

Optimize asset management

Your construction equipment may have value that you can convert to cash using one or more sale-leaseback arrangements. However, you should do so only under the right circumstances and with full knowledge of the potential drawbacks. Contact your CPA for assistance in understanding the tax and accounting implications. ■

The evolution of BIM: What contractors need to know

Building information modeling (BIM) has been around for a while. Yet the concept and software continue to evolve. New developments — including artificial intelligence (AI) — are pushing BIM to new levels of robustness and relevance. Here's what contractors need to know.

A collaborative digital tool

Conceptually, BIM aims to create digital multidimensional models of buildings, infrastructure or other deliverables during preconstruction. Stakeholders can then use and update the models during construction to refine the design and manage materials, costs and scheduling.

BIM's value springs from its capacity to unite project owners, architects, engineers, general contractors and subcontractors under a single collaborative platform. When used optimally, it increases efficiency, reduces costly errors and streamlines communication by enhancing *visualization* of the deliverable. Imagine the difference between a flat, two-dimensional set of traditional blueprints and a fully manipulable three- or four-dimensional model on a computer screen.

The latest versions of BIM software have evolved markedly from previous ones. Some go beyond three dimensions to four dimensions, meaning the element of time is linked to construction activities. This allows for the development of incredibly detailed project schedules.

Today's BIM software is also more intuitive, offering user-friendly interfaces and secure cloud-based

data storage. Enhanced clash-detection functions reduce the likelihood of design conflicts. Virtual or augmented reality features enable project teams to digitally "walk through" buildings before and during construction — boosting owner engagement and keeping everyone on the same page.

The rise of AI

As you might expect, the rise of AI is impacting BIM. AI now automates many time-consuming data entry tasks that are still necessary to run the software. This saves valuable time for project managers, estimators and other staff, who previously had to deal with these tasks.

Moreover, AI can analyze historical data from similar jobs to deliver predictive insights, noting potential risks and identifying improvement opportunities before work begins. And, as mentioned, it optimizes scheduling by associating time factors with job tasks and accounting for variables, such as weather patterns, supply chain disruptions and labor availability.

AI is also improving the accuracy of modeling data. Complex algorithms can detect design inconsistencies, suggest corrections and adjust quantities of materials based on project parameters. For construction businesses, this means more accurate estimates, precise job costing and improved financial forecasting — all of which help protect your profit margin.

Cost considerations

If your construction company is ready to buy BIM software, approach the purchase carefully. The expense will be substantial, though not necessarily unmanageable. Small to midsize construction businesses may be able to take advantage of flexible, subscription-based pricing models.

That said, you might not even need to buy the software. Project owners and design firms often host BIM platforms, giving general contractors and subs access. If you're starting to experience this, consider investing in training for the appropriate employees. You're most likely to encounter BIM on bigger, more complex jobs, as well as those operated under the design-build and integrated project delivery models.

Strategic alignment

The universe is the limit for BIM — especially now that AI is supercharging it. However, work with your CPA to ensure your technology investments align with your construction company's financial limits and strategic goals. ■

What should you do with a stalled project?

Stalled construction jobs are far from unusual. Earlier this year, software developer ConstructConnect's Project Stress Index indicated that private projects put on hold had more than doubled over the preceding 12 months, rising 110% compared with data from March 2024. If a job you're working on stalls, make sure your construction business is ready.

Assess your liability

Your liability in such situations generally depends on three factors: 1) the nature of the project, 2) the contract terms, and 3) applicable state and local law.

Try to maintain open lines of communication with the project owner.

When negotiating the contract, try to include a provision that spells out each party's responsibilities and liabilities in the event the job is put on hold. If possible, include language allowing you to perform compensated work to secure the jobsite. Whatever the contract says, work with your attorney to identify your legal rights and determine how to preserve and act on them.

Also, know your insurance coverage. The owner's builder's risk policy may cover you, or you might need to buy your own.

Secure the jobsite

For further legal protection, and to position yourself to resume work, secure the jobsite. Potential problems include instability of partially completed structures and corrosion or other damage to building components exposed to the elements. These issues can create dangerous conditions while the project is stalled and generate additional costs when the job starts up again.

If partially completed work is unstable, install temporary structural support or even dismantle the work for later reassembly. Set up temporary but sturdy protection for roofs, windows and other structural elements. Eliminate fire hazards and minimize anything that could cause someone to trip or fall.

To help prevent theft, vandalism and mishaps, ensure the jobsite is well fenced and entryways are gated and locked. Post warning signs and periodically inspect the property if you can.

Communicate with the owner

Try to maintain open lines of communication with the project owner. If the contract includes a provision allowing you to get paid for securing the jobsite, extend a friendly reminder. If it doesn't, ask the owner to authorize the compensable work under your established change order process.

In the event the owner refuses or can't afford to finance the work, carefully weigh the costs of proceeding on your own against the potential liability of doing nothing. Even if the owner won't cooperate, you may be able to recover these costs when the project resumes or through alternative dispute resolution or litigation.

Be prepared

A construction project can be put on hold for many reasons, as you've probably experienced. So, abide by the old saying: Hope for the best; be prepared for the worst. ■

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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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