

# CONTRACTOR

May > June 2008

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## 4 reasons to engage in some midyear tax planning



Smith & Gesteland<sub>LLP</sub>

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*Not The Same Old Bottom Line*

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# 4 reasons to engage in some midyear tax planning

**A**lthough you probably have plenty on your plate at the moment, don't let that fact keep you from engaging in some midyear tax planning. For starters, you'll be making your life easier come year end when you'll *really* need to start thinking about taxes. Want some more specific reasons? Here are four.

## 1. To save on equipment acquisitions

The Section 179 deduction allows you to expense, rather than depreciate, up to \$250,000 in new equipment acquisitions for 2008. This amount was raised from \$128,000 with the signing of the Economic Stimulus Act of 2008 earlier this year.

Before you run off to start shopping, though, there are some things you should know. The deduction applies to machinery and equipment, including office equipment and light trucks, that are put in service before year end. It also applies to certain software purchases.

The equipment doesn't have to be new — it just has to be new to you. But, to qualify, it must be used at least 50% for business in the first year

you own it. You can deduct only the business-use percentage of the cost, and for vehicles there are weight-related limits on the deductible amounts.

Additionally, for 2008, your Sec. 179 deduction is decreased if you spend more than \$800,000 on equipment. This phaseout amount was also raised (in this case from \$510,000) with the signing of the stimulus act.

**Earlier this year, the Section 179 deduction was raised from \$128,000 to \$250,000 with the signing of the Economic Stimulus Act of 2008.**

Also bear in mind that, under the act, some property may qualify for a special depreciation amount equal to 50% of its adjusted basis. Such property includes tangible property with a recovery period of 20 years or less, computer software purchased by the business, water utility property, and qualified leasehold improvement property.



Because both the Sec. 179 limit increases and the 50% depreciation allowance are generally available *only* for 2008 and can provide large 2008 deductions, you may want to consider making major asset purchases this year, assuming it makes good business sense to do so.

## 2. To grab the energy tax credit

If you have energy-efficient new homes under construction, try to get them completed and sold before year end. That's when a tax credit of up to \$2,000 for each energy-efficient new house is set to expire.

More specifically, a buyer must acquire it from you for use as a residence before Jan. 1, 2009. There are other criteria, as well. For example, the house must be located within the United States, and it needs to meet statutory energy-saving requirements. Ask your tax advisor to give you a complete explanation of this potentially valuable opportunity.

## 3. To better plan job progress

Now is a good time to start thinking about where your projects will stand at year end. If you use the completed-contract accounting method (available only to smaller construction businesses), you can't deduct job costs or record income until the job is complete.

Look at your overall tax and business situation to see whether it might be better to delay completion of some jobs so you can report the income next year. Conversely, it might be better to make sure all jobs are finished by year end so you can deduct the costs this year.

If you're like most contractors, you probably use the percentage-of-completion accounting method and, thus, report income and expenses as they are incurred. In this case, there may be tax advantages to pushing delivery of some materials to next year — if you can do so without hurting job progress.

More specifically, because the goods aren't delivered to the job site, you don't incur the costs and, therefore, you may recognize a lower percentage of gross profit for tax purposes. (Of course, this assumes there will be a gross profit and not a loss.)

## 4. To look into hiring your kids

Do you have children on summer break from school who are old enough to work? If so, you may hire them and fully deduct their pay. And, if your construction business is unincorporated and has no owners other than you and certain family members, and your children are under age 18, you

## Another reason to “think taxes” — strategic planning

For many contractors, the late spring and summer months are “busy season.” Thus, it's understandable that you might not care to do much tax planning right now. Yet, along with the four reasons mentioned in the main article, another great reason to engage in some midyear tax planning is strategic planning.

For instance, as you and your CPA go over your finances, looking for potential tax breaks, you may realize that business isn't going quite as well as you expected. The good news here is that there's still time to adjust. You can look into cutting expenses or maybe seeking out smaller jobs rather than a big one that could stymie your cash flow.

And if you're doing better than you planned, great! You'll be able to consider equipment purchases, computer upgrades, investments and other moves to grow your company.



won't owe any payroll or unemployment taxes on their wages.

Your kids get a tax break as well. They can earn as much as \$5,450 (the 2008 standard deduction for singles) and pay no federal income tax. They can tack on \$5,000 more tax-deferred if they contribute it to a traditional IRA. Bear in mind that your children must perform actual work and receive wages reasonably similar to what a nonfamily employee would receive.

## Act prudently

Midyear tax planning is, indeed, an excellent business practice. But it comes with a caveat: Never make a move for tax purposes if it isn't also a good *business* move. Your CPA can help you ensure that you're acting prudently from both perspectives. ■

# When it comes to diversifying, look before you leap!

**Y**ou've trimmed all the visible fat from your operations and improved efficiency as much as you can. Yet your bottom line still isn't where you want it to be. So now you're thinking about diversifying into a new market or service to improve your bottom line.

Not a bad idea. Done right, diversification can be a lifesaver. Done wrong, however, it can be, at the very least, a letdown and, at the very worst, a quick path to disaster.

## **Is your market diversification-friendly?**

A good place to start diversifying is in your local market. If you're a residential contractor, for example, you might look into whether commercial construction projects in your area are booming.

When you look to get into new markets, however, you'll likely be up against many established relationships. For example, a developer that has worked with the same commercial contractor for years could be tough to win over. You'll need to offer some solid reasons — and possibly a substantial price cut — to have much of a chance.

Alternatively, you could look into strategic partnerships or acquisitions to diversify. For example, an HVAC contractor that buys a sheet metal shop probably has effectively diversified within his or her specialty.

You could also consider looking *outside* your local market. Just bear in mind that, if you do take on jobs out of state, you'll likely face tax and permit challenges. Union contractors also need to be mindful of having to use local labor forces that they're unfamiliar with. And, obviously, you'll lack the knowledge and "home field advantage" of your market. Nonetheless, this may be a way to outflank your competitors.

## **Are you "strong" enough?**

Another factor to look at is your construction company's strengths (such as a highly skilled workforce or any specialized equipment you can bring to the table) as well as its weaknesses (poor cash flow at the moment or outdated software). Be objective, honest and realistic.



In addition, be careful: Don't assume your crews will be good at building banks just because they're good at building houses. Commercial construction isn't the same as residential. The building materials are different; the property owners tend to be more experienced and knowledgeable than homeowners; and the field is crowded and competitive. If you don't have supervisors with commercial experience, you may need to hire some.

On the other hand, commercial builders may face risks jumping into residential construction, such as building additions or rehabbing condos. They, too, will face the challenge of procuring a somewhat different set of materials. They'll also have to obtain different kinds of permits and compete against more entrenched rivals.

## **Is the timing right?**

At the end of the day, diversification is a matter of timing. If, after studying your market and operational capacity, you can't identify a realistic opportunity, you should probably postpone the idea. You may be better off gritting your teeth, tightening your belt and looking for new ways to build your core business. Diversification for the sake of diversification doesn't make sense, but you should never stop looking for opportunities to expand and improve your business. ■

# Recent NLRB rulings settle long-standing litigation

**F**ive recent National Labor Relations Board (NLRB) rulings settle long-standing litigation. The decisions came about by close margins — many were decided by 3-2 votes. And, for the most part, they favor open-shop contractors.

If you are dealing with similar circumstances, considering these rulings may be helpful, but remember that each set of facts can be subject to different interpretations. Here are summaries of the five rulings in question:

**1. *Oil Capitol Sheet Metal* 349 NLRB No. 118 (May 2007).** Contractors who discriminate by not hiring union organizers, or salts, may be required to hire the applicants. They won't, however, be automatically ordered to provide full back pay from the application date as restitution.

In the past, the NLRB has presumed that union organizers would have worked indefinitely if they'd been hired and, therefore, awarded back pay for the entire period between the discriminatory-refusal-to-hire date and the subsequent NLRB-ordered job offer.

Now the NLRB general counsel must present evidence showing that salts would have worked for the full time between the refusal to hire and the job offer. The evidence may include the union's salting policies and practices, the union's specific plans for the contractor, or agreements between the union and salts as to the expected length of their assignments.

**2. *Glens Falls Building and Construction Trades Council*, 350 NLRB No. 42 (July 2007).** Project owners can't impose union-only project labor agreements on subcontractors unless the agreements are a result of collective bargaining or are intended to avoid job-site conflicts between union and nonunion workers.

In light of this ruling, project owners may face challenges if they enter into union-only project labor agreements for reasons such as obtaining financing or appeasing unions that could oppose permitting (or otherwise delay projects).

**3. *Toering Electric* 351 NLRB No. 18 (Sept. 2007).** To get back pay in any amount, a union salt must first demonstrate that he or she was genuinely seeking employment when applying for a position.

In this case, the NLRB said it would no longer presume that every rebuffed job applicant was a victim of an unfair labor practice. The board also said, however, that employer-supplied evidence casting doubt on an applicant's intentions will be required before it will rule that a refusal to hire isn't discriminatory.

The 3-2 decision here is intended to stop salts from seeking jobs solely to generate unfair labor practice charges against open-shop contractors. In a dissent, the minority criticized the decision for failing to offer clear guidance on how an applicant's genuine interest should be determined.

**4. *Dana Corp.*, 351 NLRB No. 28 (Sept. 2007).** The NLRB ruled that employees may file decertification petitions for up to 45 days after they learn that their employer has recognized a union, based on a card-check majority. The board had previously barred election petitions immediately after card-check recognition — a practice the board now says didn't give employees adequate opportunity to opt for secret balloting.

In one case, the NLRB said it would no longer presume that every rebuffed job applicant was a victim of an unfair labor practice.

**5. *BE & K Construction Co.*, 351 NLRB No. 29 (Sept. 2007).** Contractors may sue unions in retaliation for a union engaging in protected activities, such as picketing job sites in an effort to delay construction, the NLRB ruled. If such suits are reasonably based, the board said, they aren't unfair labor practices — even if the suits are ultimately unsuccessful. ■

# Generate, authenticate, substantiate

## Winning the change order game

It's a rare, if nonexistent, construction project that goes exactly as planned. That's why savvy contractors know how to play the change order game. What are the keys to victory? In short, you've got to generate, authenticate and substantiate.

### **Generate: Where it all begins**

Where does the change order game begin? In the contract. You and your attorney need to generate language that clearly defines compensable changes and assigns financial responsibility for them, or at least make sure you understand how the contract treats changes.

**Change orders often aren't settled until months after work has been completed — and your memory won't qualify as an expert witness.**

For example, changes arising from unforeseen site conditions, such as soil problems, are typically the owner's responsibility. Conversely, you'll likely be accountable for changes caused by work-related problems, such as delays in material deliveries that force schedule changes.

To straighten out all the specifics, sit down with the owner, architect and any other stakeholders and thoroughly review the bid documents, contract, plans and specifications before you begin work. Naturally, you won't be able to predict all of the change orders that will be needed, but holding such a meeting will help everyone recognize that it's in their own best interest to work together to minimize problems.

### **Authenticate: Get it in writing**

In an ideal world, you would clarify the scope of every possible change and get orders for them in writing — with pricing — before you begin work. In reality, you can't stop work in the middle of a job to bicker over the cost of a change.

You can, however, get acknowledgment in writing that the work isn't a part of the contract. If an owner won't provide such acknowledgment, go

on record — in writing — that you're doing the work even though it's outside the scope of the contract.

In this age of e-mail, there's really no excuse for not having a written record of your change-related communications. Plus, it's important to bear in mind that change orders often aren't settled until months after work has been completed — and your memory won't qualify as an expert witness.

For instance, say bad weather makes it impossible for you to work for an extended period and, initially, the owner agrees to shut down the job site until conditions improve. Sounds fair enough, right?

But what if, when the delay lingers on longer than either of you had expected, the owner suddenly asserts that he'd never agreed to such a lengthy extension? Without any documentation to prove otherwise, you could very well end up paying a penalty for missing the contractual deadline.

You can avoid such situations with good day-to-day procedures. Require project managers to keep daily logs of job progress — particularly noting any occurrences that may lead to the need for a change order. And when things aren't consistent with the work stipulated under the contract, contact the owner immediately.

### **Substantiate: Document everything**

If everyone agrees a change is necessary, document it. Be comprehensive: Again, you probably won't



remember every detail six months down the road. Correct errors or omissions in writing.

Update your schedules regularly, too. If a change affects the job schedule, you'll need documented evidence of how and when it occurred and what resulted.

One frequent weakness in change resolution involves contractors who can't prove there was a link between a change request and increased costs. To create such a link, keep a detailed history using your own project documents and logs and any correspondence.

Meticulous record keeping not only helps ensure that disputes are settled in your favor, but it also can help speed the dispute resolution process. It's a rare owner who will insist on litigation or arbitration when faced with a stack of documentary evidence in your favor.

#### **Worth the effort**

Change orders can easily make or break a project — or even a construction business in the long term. That's why putting forth the effort to prepare for and diligently carry out a winning change order process is so important. ■



## Construction Success Story

### Family business squabbles speak to future opportunities

Initially, the owner of a homebuilding and rehab company in a historically lucrative suburban area was glad when his son and daughter decided to join the family business. Yet his happiness turned to dismay when his two offspring almost immediately set to bickering.

Having a more aggressive business style, the son wanted to diversify the company into office rehabs and maintenance on large industrial buildings. The daughter, meanwhile, was more cautious. She wanted to narrow the company's specialty and turn it into more of a "boutique" construction business that focused solely on environmentally friendly single-family home projects.

The owner soon found himself caught in the middle. For help, he turned to his financial advisor, who could provide an objective, business-oriented perspective that would keep matters from becoming too personal.

The financial advisor first pointed out that expanding into new areas could indeed pay off in more jobs and greater market share. Then again, moving too quickly into new areas could strain the company's cash flow and spread resources too thin. (For more on the pluses and minuses of diversification, see "When it comes to diversifying, look before you leap!" on page 4.)

At the same time, the advisor noted that specializing in green homebuilding could allow the owner to use his money and resources more efficiently while raising his company's visibility in an increasingly popular market segment. Yet he should take care to avoid cutting his profitability by missing out on jobs and altering many of his company's tried-and-true building processes.

To help settle the conflict, the advisor set up a meeting in which she could use the company's financial statements and historical job data to project just how the business might fare in either venture. During the course of the meeting, she was able to mediate between the son and daughter, giving each of their positions equal respect without appearing to play favorites.

When all was said and done, the construction company owner decided on a middle-ground approach. He would keep his construction company in its current market but look for opportunities to let his son and daughter head up reasonably sized projects in their respective areas of interest. In doing so, he could get a better idea of where his company's future might (or might not) lie while letting his children pursue their individual visions.

# The expertise you need, the service you want.

**A**t Smith & Gesteland, LLP we know that running a successful construction company these days requires more than just dedication and hard work. It takes the assistance of experts who understand the industry and the challenges contractors face, and who have the specialized knowledge, hands-on experience and service commitment it takes to help them achieve their business goals.

Our Construction Industry Services Group consists of experienced professionals focused on increasing the success of companies like yours. For more than 50 years, our firm has served individuals and businesses throughout south central Wisconsin. We are delighted to currently work with more than 100 contractors and to have recently been voted Madison's Number 1 accounting firm. We are ready to assist you with a broad range of services tailored specifically to your needs, including:

- Profitability improvement
- Cash flow projections
- Quality and productivity enhancement
- Estimating/bidding improvement
- Bonding capacity maximization
- Lease vs. purchase analyses
- Tax reduction strategies
- Business valuations
- Succession and estate planning
- Financing assistance / growth management
- Project management and accounting systems
- Litigation and claims support

As specialists in the construction industry, Smith & Gesteland has developed the expertise needed to help contractors address and meet their many challenges. We would welcome the opportunity to help you build your success.

To find out what we can do for you, or for more information about the ideas presented in this newsletter, please contact John Folsom or Steve Pullara at (608) 836-7500 or [mail@sgcpa.com](mailto:mail@sgcpa.com). We look forward to talking with you.

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