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Better Ways ▲ Better Results

A NEWSLETTER FOR THE CONSTRUCTION INDUSTRY

WINTER 2009

Best Practices When They Matter Most Challenges for Contractors in Tough Times

When the dust clears after an economic downturn, the sorting out process becomes clear. Some contractors have failed while others have thrived.

What's the difference between them? That question has been studied in business schools and construction institutes. Generally speaking, these studies indicate that the companies that will emerge successfully from this down cycle will be those that effectively implement the best practices that follow.

- **Conserve cash.** Don't go into a slowdown without a ready cash flow. Plan for enough liquid and easily convertible assets to last the full year. Turn receivables to revenue, sell idle equipment and stock only the inventory you need. Finance equipment instead of buying it outright. Pay bills in installments when possible and never pay in advance without a good discount.
- **Work smarter.** Some of your company's inefficiencies you know about, others you don't. Either way, it's time to find and fix them. A roofer who can shave a week off a project can start up early on another one, or use the savings and time for a marketing blitz. Now's the time to lift with your head, not your back.
- **Be selective.** It's easier said than done when low-margin jobs, unreasonable contract demands and temperamental clients seem to be the only ones out there. But a take-any-job-to-keep-working approach rarely works: Succeed



too well and you'll be out of business. And don't venture too far afield, either in geography or type of work.

- **Formalize procedures.** Sunny times are forgiving but economic storms demand a tight ship. Estimating, purchasing, operations, change orders, workforce – step back, identify weaknesses and fix them. If your competitors are running on strong processes, communications and controls and you aren't, they'll move ahead quickly.
- **Control growth.** Even in a slowdown, some contractors grow out of control. The best goal in a soft market may not be growth, but rather profitability.

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New Tax Incentive Are Here



In January 2008 Congress enacted the Economic Stimulus Act of 2008. Most public attention has focused on its rebate checks to taxpayers and funding for government-backed mortgages.

But the Act also includes two important tax changes intended to promote investment by small and mid-size companies. Both incentives are significant for construction contractors that own land, buildings or equipment – and taking advantage of them requires action before the end of the year.

A One-Time Bonus . . .

One economic stimulus that Congress held out to business is a one-time bonus for 2008: the right to deduct 50 percent of the cost of new equipment this year, rather than spread it over several years.

Such “accelerated depreciation” isn’t new. Congress first introduced it in 2002, when it permitted a one-time deduction of 30 percent for qualified property in its first year of service. Eighteen months later the bonus depreciation deduction rose to 50 percent – but it wasn’t available for most property purchased after 2004.

Now bonus depreciation is back. The 2008 Act lets companies deduct 50 percent of the adjusted basis of qualified investments made this year. Qualified investments include most new equipment with an expected lifetime of less than 20 years, and certain improvements as well.

This one-time bonus deduction will cause an adjustment to the property’s basis and subsequent depreciation value. But it comes with fringe benefits: A short taxable year doesn’t reduce the deduction, contractors can opt out for any class of property, and it causes no adjustment to the Alternative Minimum

Tax. The effect is to lower the effective cost of capital investment.

. . . and Higher Limits on Expensing

Normally, contractors can deduct most large expenses only over the course of several years. But Section 179 provides an exception by which certain property can be “expensed” – that is, deducted in the year of its purchase, up to a certain limit. Congress has now raised that limit substantially to \$250,000.

When Section 179 first appeared in the IRS code in 1997, it set a deduction ceiling of just \$18,000 for expensed property. Before 2008 the limit had reached \$128,000, and the new Act nearly doubled that to \$250,000. (The limit is reduced, however, to the extent by which the cost of the qualifying property exceeds \$800,000.)

Section 179 still limits the deduction to the amount of the contractor’s taxable income from active businesses. But it also continues more lenient rules for expensing empowerment zone, gulf opportunity (GO) zone and renewal properties. And the deduction doesn’t activate any AMT adjustments.

According to Vito Loisi, partner and a member of Wolf & Company’s *Construction and Real Estate Industry Group*, “Taken together, this means that many small and mid-size contractors can claim a full deduction

for equipment purchased in 2008. That means the true price of such equipment is significantly reduced.”

Act Before Year-end

The purpose of the Economic Stimulus Act of 2008 is to encourage investment and growth with tax incentives that lower the effective cost of equipment, land and leasehold improvements. As the year draws to a close, contractors should take the time to consider potential purchases and improvements in that light. ■

Our firm can help you use the 2008 depreciation and expensing changes to your advantage. For more information contact Vito Loisi at 630-545-4554.

Qualifying Property

The IRS rules for calculating tax deductions under Section 179 and bonus depreciation are somewhat complicated. Here’s a summary of qualifying property:

For Section 179:

- Machinery and equipment
- Furniture and fixtures
- Off-the-shelf software
- Automobiles used more than half for business
- Gasoline storage tanks
- Livestock

For bonus depreciation:

- New assets
- Assets covered by the IRS’s Modified Accelerated Cost Recovery System (MACRS) with an expected lifetime of less than 20 years
- Certain fixtures, interior decoration and improvements
- Off-the-shelf software

Don't Miss Out on Carryback Losses

The soft construction market has lasted long enough to make the IRS provision for carryback losses a timely one for many contractors. When a business sustains losses in a tax year, deductions may exceed income, resulting in a net operating loss. Taxpayers can file claims to "carryback" such losses — that is, apply them against income in prior years — and receive a refund of taxes already paid.

Some builders and developers, are currently selling land at substantial discounts, according to The Wall Street Journal. They don't expect land values to rise soon, and by applying a 2008 loss to 2006 (for most, a profitable year), they can mitigate the worst effects of the downturn. In 2007 the IRS processed more than 60,000 carryback loss refunds, for a total of almost \$1.2 billion.

What about a contractor's status in the eyes of a lender or surety company? A carryback claim only registers a loss that already exists on financial statements, so interested lenders and sureties are already aware of it. And the expected refund

can be booked as a receivable — which, depending on the amount, can improve the contractor's standing with the lender or surety.

The loss can be applied only to the last two years. It's applied first to the earlier year, and if it exceeds that year's income, the remainder is applied to the second year. By carrying back a 2008 loss, contractors can take advantage of 2006 (if that year was profitable for them). ■

Take a look at your carryback loss prospects. We'd be happy to help.



Contractor Challenges

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- **Solidify relationships.** Revisit customers first, because the best return on your marketing dollar comes from return customers and the referrals they send. Then call on lenders, show them your plans, listen to their concerns and help them help you. Line up vendors, subs and top performers, remembering that a low price may save you some silver, but a partner devoted to your success is gold. Finally, leverage your professional advisors and their experience to help you weather this storm.
- **Plan realistically.** In order to forecast for the next few years, look at your margins eight to ten years ago. If you can't, use recent history but discount for the downturn.
- **Sharpen your estimates.** As residential construction shrinks, homebuilders and subcontractors will enter other construction markets and bid competition will intensify throughout the industry. Companies that understand their capabilities, based on actual performance data, can bid successfully.

Easier Said Than Done

Not every company can implement all of these practices. Some seem contradictory — if you lay off workers to avoid a low-margin job, how can you increase employee retention? How can you turn down jobs and build cash at the same time?

That's why hard times are called that. Navigating challenges, balancing solutions and finding the sweet spots takes discipline, a cool head and objective professional assistance. ■

If you're ready to improve your business in a harsh environment, our firm is ready to help. For more information call Joel Dziedzic at 630-545-4508.

Cash on the Back Lot

Plenty of assets bought with cheap money three or four years ago are sitting idle or only working part-time. If a backhoe's wheels aren't turning, the asset isn't earning.

What's parked out back? You may be able to turn it into cash in several ways.

- **Sell it.** Used equipment prices are holding steady, driven by international demand, but that may not last. The first step is to have your fixed assets assessed, so you'll be in position to act quickly on a good deal.
- **Refinance it.** If you owe money on equipment, consolidate it into a longer-term loan while rates are still low to reduce payments and even generate cash. And assets can serve as collateral for a new credit line.
- **Lease it out.** Maybe your competitors have gotten a little too lean and they need your bulldozer. Don't gouge them — help them out. It may lead to other opportunities. When you can't work your capital yourself, it can earn its keep through leasing.

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Construction Briefs

Weaving Generations in the Workforce

I can't find quality people.

Employees aren't the only factor in construction success, but they're a big one. So why are some contractors better at finding and keeping productive employees than others? To answer this question, ask yourself some others. Do you pay for training? Do you provide good health benefits? Do you offer flex-time or help with daycare?

In the past, the construction industry largely took a one-size-fits-all approach to employment. Welcome! Everyone has the same benefits, the same vacation time, and we all pitch in for overtime. You'll start out reporting to an older guy, but hang in there and someday you'll move up the ladder.

But the industry is diversifying rapidly today. Today's employees bring different values and expectations to the job — ideas that reflect different national and ethnic backgrounds as well as different generations.

An energetic, childless young fellow on his first job may shun life insurance, but take all the overtime he can get. A middle-aged single parent probably values flex-time and good insurance. They're both good employees; can't a contractor accommodate both?

The first step is a generational survey, seeking information on preferences. Another useful tool is a quality survey — especially an anonymous one that asks questions like, *Do you feel like quitting? Why?*

What would you change? The goal is the same: to understand the makeup of the organization and what people want from the job. When you know more, you can make changes.

One proven approach is offering a menu of benefits. Some employees want daycare, some want flex-time, some want more vacation, and some want training. Such a menu can be structured for both hourly workers and management and can reward loyalty with more choices the longer an employee stays.

Success at weaving the generations takes foundational cultural change, and building a strong "employment brand" can be costly. But the benefits make it worthwhile. ■