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CERTIFIED PUBLIC ACCOUNTANTS AND CONSULTANTS

Dimensions

A CPA's Report for the Construction Industry

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Make Energy Efficiency Pay

How Section 179D Deduction Can Benefit Contractors

Energy efficient buildings can offer their owners significant long-term savings. But in some cases they could also generate a more immediate tax benefit to contractors and subcontractors.

The potential tax benefit stems from a provision of Internal Revenue Code (IRC) Section 179D, which offers a tax deduction to building owners who install certain energy-saving systems or improvements. The deduction is available for both new construction and improvements to existing buildings, provided the systems are certified to meet the defined criteria.

The potential benefit to contractors and other building professionals occurs when such installations are made to public buildings or commercial buildings owned by government entities. These entities pay no income taxes, so Section 179D allows the deduction to be allocated instead to the taxpaying entity that was primarily responsible for designing the improvements.

The deduction can be allocated to a single designer or allocated among multiple designers such as architects, engineers, general contractors and subcontractors who played a role in designing the qualifying systems.

How It Works

IRC Section 179D provides a tax deduction of up to $1.80 per square foot for installing qualifying systems that improve energy efficiency in three areas:

1. Lighting and lighting controls;
2. Heating, ventilation and air conditioning (HVAC), including water and hot water systems; and
3. The building envelope, including the roof, windows and doors.

The full $1.80 per square foot deduction is available only on buildings that achieve at least a 50 percent reduction in total energy and power costs. The improvements must be inspected and tested by a qualified engineer or contractor who is registered in the building's jurisdiction.

The reduction is measured against the minimum requirements outlined in the American Society of Heating, Refrigerating and Air Conditioning Engineers (ASHRAE) Standard 90.1-2001. For buildings placed in service after Dec. 31, 2015, the relevant standard is ASHRAE 90.1-2007.

For the 2016 tax year, the deduction is available for qualifying systems placed in service before Jan. 1, 2017.

The savings are calculated separately for lighting, HVAC and building envelope systems. In other words, the building may qualify for a partial deduction of up to 60 cents per square foot in each of the three areas, even if the other building systems do not qualify. The amount of the deduction cannot exceed the actual cost of the improvements.

The Size of the Opportunity

The size of the potential tax deduction can be significant. On a 120,000 square-foot commercial building, the owner could be eligible for a total Section 179D deduction of up to $216,000. This assumes that energy usage is reduced by at least 50 percent over the relevant ASHRAE standard in all three categories.

Again, remember that when these savings are achieved and certified in a public building, the tax deduction may be allocated to the architects, engineers, contractors and subcontractors who were responsible for designing the improvements.

There have been proposals in Congress over the years to expand this provision to include all types of not-for-profit entities, but for 2016 the allocation is available only for public

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Succession Planning

Cash Flow Needs Will Drive Your Strategy

Succession planning can be one of the most challenging issues a contractor faces. But in most cases, it's a challenge that can't be avoided.

Here are some factors to bear in mind as you evaluate your succession options.

Cash Flow: the Critical Factor

In almost every instance, the first factor to be considered is the expected cash flow you will require after you exit the business.

Are you moving on to a new business opportunity and in need of immediate cash to finance it? Or are you retiring and need steady income to maintain a comfortable retirement lifestyle? Do savings or other income make cash flow a secondary consideration? Answering these questions can help you start zeroing in on the most appropriate exit strategy.

If immediate cash is needed, selling to a third party could be the fastest and simplest strategy. In a partnership or closely held corporation, the other partners or shareholders might be likely buyers.

In other situations, however, there may not be a large pool of potential buyers. In this scenario, it's important to be realistic about the expected valuation of your business. This is particularly true if a good portion of your company's value is dependent on goodwill and your personal reputation.

If this is your preferred exit strategy, find ways to maximize the value of your business over and above the liquidation value of the assets. For example, long-term contractual relationships or ongoing revenue streams (such as service contracts) will add value that can be transferred to a new owner.

Looking to the Next Generation

One of the most common exit strategies in the construction industry is to transfer ownership to family members. In fact, that's often one of the original objectives for establishing a business.

But choosing this option opens up many questions, including tax consequences and estate planning concerns that must be addressed. Moreover, unless the transfer is to be an outright gift — which opens a whole new can of tax questions — financing the transition is often a challenge.

Owners' or partners' children typically don't have enough money for an outright purchase, so some type of financing arrangement is usually necessary. Lenders can sometimes be reluctant to finance such a purchase since the increased debt could cause cash flow problems or restrict the company's bonding capacity.

The sooner you select a strategy and start working toward it, the more likely you are to achieve your goals and leave the business in good hands.

One alternative is for the purchasers to create a separate holding company to purchase the operating company. Such an arrangement can help segregate the debt from the operating company's financial statements. In addition, some lenders might be willing to collateralize such a loan (at least partially) with the holding company's stock, although personal guarantees are also likely to be required.

Seller financing is another common strategy, particularly if the seller's cash flow situation means an immediate cash payout isn't necessary. Another alternative is to transfer day-to-day management of the business to the next generation while retaining your ownership interest and an ongoing salary.

The Role of Life Insurance

Life insurance can be a useful tool for facilitating some types of exit

strategies. For example, in the case of a seller-financed sale, the company typically would purchase a policy on the selling owner. Then, upon the seller's death, the company would use the policy proceeds to purchase the seller's stake from his or her estate.

In other instances, sellers might agree to receive interest-only payments until their death. This way, they can keep any capital gains off their tax returns until the company becomes part of their estate. At that point, life insurance proceeds can help mitigate the tax consequences.

Various combinations of seller financing and insurance can also be used to transfer ownership to key employees or an internal management team. In some instances, an employee stock ownership plan (ESOP) could be an option. But ESOPs are subject to special IRS provisions along with specific Department of Labor rules, so often they are practical only for relatively large organizations.

Regardless of the exit strategy you eventually choose, it's important to start planning the transition early – ideally, a number of years before the transfer will actually take place. The sooner you select a strategy and start working toward it, the more likely you are to achieve your goals and leave the business in good hands. ■

Call us today for more information on succession planning and business transition issues.

Joint Ventures

Pros, Cons and Best Practices

A joint venture can open new doors for your business, but every joint venture also presents unique risks and potential pitfalls. By understanding the pros and cons and some industry best practices, you can help improve the odds that a joint venture will be successful.

What a Joint Venture Can Offer

A joint venture can provide your company a variety of benefits. Some of the more common advantages include:

- Increased financing and bonding capacity to compete for larger projects.
- The ability to share costs and spread risks.
- Access to specialized expertise that's needed for a specific project.
- Acquisition of new skills by working with an experienced partner.
- Access to specialized or costly equipment.
- A foothold in a new geographic market or new type of project.

What Can Go Wrong

As with most business decisions, making a wise choice about a joint venture means balancing the expected benefits against the potential risks. Common pitfalls include:

- A vague or imprecise agreement in which responsibilities and expectations are not clearly defined.
- Unequal contributions, either real or perceived, which cause one party to feel the other is not pulling its weight.
- Financial problems, particularly when cost overruns on an unrelated project inhibit a partner's ability to meet its joint venture obligations.
- Incompatible cultures and management styles, especially involving mission-critical practices such as safety and jobsite protocols.
- Poor communication, both at the outset and throughout the project.

Look Before You Leap

In addition to weighing the risks and rewards of a joint venture, a prudent contractor will also take steps to improve the odds of a successful relationship. Important steps include:

1. **Understand the rationale for the venture.** Each party must bring something to the table that the other needs, such as knowledge, skills, equipment, geographic presence, political influence or the ability to meet specific qualifications. Clearly understanding each party's contribution is a basic requirement.
2. **Analyze strengths and weaknesses.** Each party should complement the other's attributes. For example, one company might possess technical expertise, while the other knows the local market or the project owner. Structure the joint venture to take advantage of each party's strong suit.
3. **Choose carefully.** Evaluate your respective management styles and determine how to collaborate without stepping on each other's toes.
4. **Establish mutual trust.** If there is any doubt that the other company might not act ethically, it's better to walk away — regardless how attractive the opportunity might be.
5. **Get it in writing.** Have your attorney draft a formal joint venture agreement that spells out every detail of the relationship. This includes financing, management, decision making and procedures for resolving conflicts.
6. **Define the end at the beginning.** The process for wrapping up the joint venture should be agreed upon at the outset. Critical questions include the disposition of any jointly acquired assets and the resolution of any joint liabilities, including warranties.

Partnering with another contractor to share resources, strengths, know-how or opportunities can be very beneficial. However, a successful joint venture requires careful planning and an atmosphere of mutual trust and respect. ■

Our firm can help you analyze the financial and strategic impacts of a joint venture. Call us for more information.

The Section 179D Deduction

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or government-owned buildings. The suggested expansion is likely to come up again in 2017 when Congress considers extending the deduction past its current expiration date.

In addition, contractors who build or improve their own buildings could be eligible to claim the deduction directly, provided they meet the savings requirements.

Identifying Likely Opportunities

Qualifying for the full $1.80 per square foot deduction requires detailed energy usage modeling using software approved by the Department of Energy. The certifying engineer must be an unaffiliated third party, so there is some additional cost in filing for the deduction.

Yet even a partial deduction could produce a significant tax benefit. If you have not yet done so, now is the time to review your completed job lists to identify government buildings that could qualify to be included on your upcoming 2016 tax return.

After verifying that the Section 179D deduction has not yet been allocated, the next step would be to hire a qualified engineer to test and certify the improvement. Then request the government entity to issue an allocation letter for use as supporting documentation for the deduction. ■

IN 1944, Thomas Saltmarsh, Harold Cleaveland and Charles Gund pooled their talents and modest resources to form a partnership for the practice of accounting. The three founding partners soon established a client base that included large and small businesses, as well as commercial and governmental accounts. Their success was attributed to their guiding principles of honesty and integrity, accuracy and thoroughness, quality client service and, most importantly, the belief that service to the community is an individual as well as a corporate, responsibility.

TODAY, Saltmarsh offers a variety of services — from accounting and taxation to consulting — all based on the Firm's mission statement and core values. It is this philosophy, based on the principles of yesterday, that has helped the Firm grow to one of the largest locally-owned certified public accounting firms in the Southeast.

SALTMARSH CONSTRUCTION ADVISORS are here to meet the specific needs of contractors, home builders and related trades within the construction, real estate and development industries. Because we truly understand construction accounting and financial management, contractors and developers of all sizes and different trades rely upon our experience. Need assistance? Contact the construction advisors at Saltmarsh or call us today at 800.477.7458.

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Skilled Labor Shortage? Try Cross-Training

As they struggle with the ongoing shortage of construction labor, many contractors are rediscovering the advantages of cross-training employees in related skills. Here are a few benefits that multi-skill training can offer:

Reduced turnover: Cross-training strengthens workers' sense of job security. This, in turn, can help reduce turnover and the related costs of recruiting, hiring and training new workers (if you can even find them).

Improved productivity: Experienced, multi-skilled employees help companies finish more projects on schedule, with fewer accidents and higher margins. Contractors whose workers are cross-trained in related skills may also be able to complete jobs with a smaller workforce. This is a real advantage in today's tight labor market.

Greater flexibility: A cadre of multi-skilled workers can help you respond more nimbly to unexpected developments. If a subcontractor misses a deadline or weather delays a critical process, cross-trained employees can be reassigned to other tasks.

Shorter learning curve: Current employees can leverage their construction experience and start training for a second or third skill at a point beyond the beginner stage. And they often can complete training programs sooner.

Cross-training is not a cure-all, however. Some highly specialized positions aren't logical candidates for cross-training. And you might encounter some resistance from older workers who are less interested in new and varied opportunities than younger workers.

A union environment can also pose a challenge, although some construction unions are easing certain work rules and restrictions. Be prepared to adjust your compensation practices so that workers can expect consistent pay, regardless of the task they're assigned on any given day.

Despite these potential limitations, offering workers cross-training opportunities can be of real benefit to both your company and your employees. ■