

# *building* SUCCESS

## How to save taxes:

### **Minimize capitalization**

If you are involved in the construction of buildings and other real property, you are generally not allowed a current income tax deduction for interest on costs associated with those construction activities.

Rather, you are required to capitalize construction interest during the construction period. Capitalized interest becomes part of the cost of the project and reduces your gain when you sell the property.

**It is advantageous to pay attention to the interest capitalization rules to minimize the amount of interest that must be capitalized.**

Interest not related to construction, and interest incurred before or after the construction period, is deducted currently. Most contractors prefer to claim their tax deductions sooner.

Accordingly, it is advantageous to pay attention to the interest capitalization rules to minimize the amount of interest that must be capitalized.

#### **Production costs**

The tax law requires builders to capitalize the direct and indirect costs related to construction projects.

Direct costs include the cost of materials used in construction and costs directly associated with construction.

Indirect costs that must be treated as construction costs include those that directly benefit construction or are incurred because of construction. Examples of indirect production costs include the cost of hammers, saws and other tools and depreciation of cranes, compressors and other equipment used in construction.

In some cases, indirect costs may be construction-related and also benefit other activities. When that

happens, you should make a reasonable allocation to determine the portion allocable to the construction activities.

#### **Interest**

The amount of interest on construction-related debt is determined using the "avoided cost method."

You look at the total debt of the business. The construction-related debt is measured by determining the amount of debt that would have been avoided if the construction had not taken place, and all construction expenditures were used to repay any indebtedness. The interest on that debt must be capitalized as a cost of construction.

Any debt that can be specifically traced to construction is considered construction-related. If construction expenditures exceed the amount of debt specifically traced to the construction, other debt is allocated to the construction activity. The interest rate applied to this additional debt is the weighted average of the interest rates on all debts outstanding during the construction period, other than debts specifically traced to the construction.

If you receive progress payments, you must capitalize interest costs to the extent your construction expenditures exceed the accumulated payments received from your customer.

Interest on debt incurred or continued to finance construction assets, such as machinery or equipment used to construct the property, also must be capitalized to the extent it is incurred during the construction period. If the assets are used both to construct property

see **Tax deductions** on back

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### **INSIDE**

Use technology to collaborate for successful projects



Old concept still works: Try management by walking around



*An information bulletin to contractors from:*



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## Old concept still works: Try management by walking around

In 1982, Tom Peters and Robert Waterman published an acclaimed business book called *In Search of Excellence*. They espoused a practice of "management by walking around" as a way to achieve excellence.

They were on to something then, and the lesson still applies today.

We've all heard comments about the "ivory tower" in business. Employees complain about decisions that come from the top, when the "real work" goes on at the bottom. While this may not be entirely true, there are many times when top management is too far removed from the front lines to understand the problems and develop good solutions.

The world of construction is no different.

Walking around a job site can tell you a lot about the status of the project, the practices of the project and site managers, communication among team members and compliance with company standards. In fact, no other activity can tell you more about these things. And the larger the company gets, the more truth there is in that statement.

If you're going to practice "management by walking around," here are a few tips you might want to keep in mind:

**Make this a regular activity.** You should schedule time to walk the job sites and the corporate offices so that you get an ongoing picture of life in the trenches. The occasional walk-through may give you a distorted view. You might catch employees on a really good day or a really bad day. Regular walk-arounds will help you gauge the true climate of the department or job site. You don't want to make rash judgments based on anomalies.

**Don't become the police.** When you're walking around, you aren't looking for trouble – you're just looking. If the troops receive only corrective feedback when you come around, they'll dread seeing you, and you'll miss out on a big benefit of being present. Look for examples of good behavior and speak to it. Ask questions of the team to see what they struggle with and what they are proud of.

**Don't over-react to situations.** Just because you're on site doesn't mean the chain of command goes out the window. If you notice issues that need to be addressed, talk with the appropriate manager about addressing them. You're not there to undermine someone else's authority or to be the "heavy." Help your managers learn to manage better, and reinforce to the team that the manager is in charge of the



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site. The exception, of course, is a safety hazard that you may need to address on the spot. Be sure to debrief the manager on your conversation with any employee on any safety-related issue.

**Don't spend too much time with the site managers.**

You probably have opportunities to talk to your site and project managers more often than you do to those who work under them. Use the site visit as an opportunity to get closer to the front. Walk around by yourself while you're talking with workers and asking for their input. You don't want to put them in an awkward position in front of their supervisor, and you may find that you'll get more honest feedback if you're alone.

**Reinforce the guiding principles of the company.**

It's easy for front-liners to get so involved with the work that they fail to see the connection to the company's vision or mission. As you talk with employees while you're walking around, reinforce how they contribute to the fulfillment of the company's mission. People want to feel that their work matters – you can help them make the connection by talking with them.

Running a successful construction company is a big job. Important work does go on in the proverbial ivory tower, but nothing can take the place of seeing for yourself what goes on at the project sites on a regular basis. Make it a priority. Learn from it. It can be an important part of your quest for excellence. – Denise Altman, MBA, CPA

## Use technology to collaborate for successful projects

You already know that you can do larger, more creative projects when you work with others closely.

But how do you manage the work?

How can you effectively work with people who are not in the same office, city, state or country? How do you keep profitability high and projects on time when others are involved?

Frequent, effective communication is certainly one way, and technology is also one of those levers.

Collaboration takes many forms, but three broad categories in which technology can be leveraged occur frequently. They are: moving files, communications and remote access. Each of these categories is discussed below, and then possible tools to help are suggested.

**File transfer.** Design documents are critical to the success of any large-scale project.

Whether we are talking CAD documents in AutoCAD or Rivet, design specifications, change orders or approvals, or Building Integrated Modeling (BIM), we have to be able to easily move and control very large documents.

E-mail is not the answer for this. But file transfer applications can be.

We suggest YouSendIt for free or low-cost transfers and ShareFile for more control and larger file transfers.

Additionally, workflow software can help with signoffs or approvals, but crossing systems with collaborators is still a challenge in this area, even in large-scale projects that have systems available.

Some organizations are attempting to use Microsoft SharePoint for both file transfer and workflow, but the costs of building such a system can be high.

**Communications.** Active and accurate communications can make the difference between a successful project and failure. All communication tools can be used well or poorly, so you will want to have firm standards in place to be most effective.

Simple tools like e-mail or e-mail-enabled mobile phones can allow for status and questions to be communicated directly and with some immediacy. This allows people working in the field to coordinate

with people in other locations or in the main office.

However, some items are better both seen and heard. We recommend investing in video collaboration for maximum effectiveness. The new twist in technology is free or at least inexpensive videoconferencing, available with Skype, Microsoft Office Communicator and others when enabled with a \$100 Web camera.

These tools give you the ability to send instant messages to other users, include a simple visual status of your availability – called presence indicators – and have the ability to use VOIP and video to communicate. More sophisticated setups can use remote document cameras and full videoconferencing in HD quality if needed.

**Remote access.** You can share documents and activities with others or access your own materials in the office with remote access tools. There are several approaches and solutions to this problem that vary in price from free to a full remote deployment that can be run in a supervisor's job site trailer or from a foreman's vehicle.

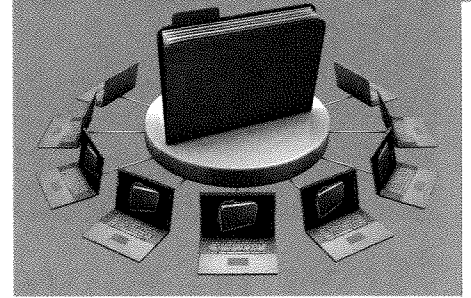
If you want to be able to access another machine remotely, look at the remote control tools available in the market. If you'd like to be able to access all of your applications including design, accounting and workflow from the field, consider desktop virtualization with a tool like VMWare View.

What technologies can be helpful for collaboration whether across the office or across the globe?

The following list includes some tools that are free and some that have licensing fees. All help architects, engineers, construction companies and their supporting collaborators to be more effective.

1. File transfer and coordination
  - a. YouSendIt
  - b. ShareFile
  - c. LeapFile
  - d. Microsoft Tools
    - i. SharePoint
    - ii. Groove
    - iii. SyncToy
    - iv. Windows Live Mesh

Frequent, effective communication is one way to keep profitability high and projects on time when others are involved.



2. Communications
  - a. E-mail
  - b. Mobile phones that are e-mail enabled
  - c. Skype, particularly video-enabled with webcams
  - d. Microsoft Office Communicator
  - e. GoToMeeting
  - f. WebEx
  - g. Polycom HD Video Conferencing
3. Remote access software
  - a. TightVNC
  - b. GoToMyPC
  - c. LogMeIn
  - d. Bomgar
  - e. I'm in Touch
  - f. TeamViewer
  - g. NTRGlobal
  - h. VMWare View
  - i. Microsoft RDP with App-V
  - j. Citrix XenDesktop

Clearly, these are not all of the collaborative tools available.

We have not discussed portals, workflow or accounting software that may have some of these features available or included. As you plan your collaboration, focus on the key issues you are having in your business. Then consider your ideal work scenario.

Plan how you'd like your teams to coordinate in your ideal world, and select a few tools to start with that you believe your team can handle.

Add the tools with the proper infrastructure, training and vision explained, and watch the improvements in results. You'll wonder how the job ever got done before your team was enabled for collaboration. – CPAmerica technology consultant Randolph Johnston

## Tax deductions *continued from front*

and for other purposes, only the portion of the interest allocable to the construction activity must be capitalized.

### Construction period

You are required to capitalize interest only during the construction period. The construction period begins when physical activity is first performed on the property and ends when all production activities are completed and the property is ready for sale.

**Accurately determining the unit of real property, the beginning and end of the construction period and the amount of construction debt can be a complex process.**

The construction period may begin before structural work commences. Activities such as clearing or grading in preparation for construction can start the construction period. The construction period is also considered begun if infrastructure, such

as roads, sewers and sidewalks, is added to the property.

On the other hand, planning and design, such as soil testing, preparing architectural blueprints or models, and obtaining building permits, are not physical production activities.

The construction period ends when all reasonably anticipated construction activities are completed.

For example, a home builder's construction period ends when the home is completed and awaiting a buyer. However, if structural work on the home remains undone to allow a prospective buyer to select finishing aspects, the construction period may continue.

The construction period must be determined for each "unit" of real property. These rules provide that the various components of a project are treated as a single unit of property if they are "functionally interdependent." Components of real property individually held for resale to customers are not treated as functionally interdependent. For example, individual dwelling units within a multi-unit condominium project are treated as separate units of property.

When the production period begins for any functionally interdependent component or any common feature of the unit, the production period begins for the entire unit.

Accurately determining the unit of real property, the beginning and end of the construction period and the amount of construction debt can be a complex process.

But the effort may be worth it, if you qualify for your interest deductions sooner. – *Michael Redemske, CPA*

The technical information in this newsletter is necessarily brief. No final conclusion on these topics should be drawn without further review and consultation. Please be advised that, based on current IRS rules and standards, the advice contained herein is not intended to be used, nor can it be used, for the avoidance of any tax penalty assessed by the IRS.

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