



CONSTRUCTION INDUSTRY ADVISOR

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Classify carefully

IRS continues to scrutinize independent contractors

The classification of workers as independent contractors or employees has significant implications — both tax and nontax — for all businesses. But this issue is particularly important for construction companies, given the widespread use of subcontractors in the industry.

In recent years, the IRS has been cracking down on employers that misclassify employees as independent contractors, and the consequences can be costly. Although the agency's enforcement efforts won't likely be in full force this year given the unfortunate development of the novel coronavirus (COVID-19) crisis, you can never be too careful.

Advantages of status

As you're probably aware, treating a worker as an independent contractor provides significant advantages for employers. You avoid costs associated with withholding and remitting federal income and payroll taxes, as well as paying the employer's share of payroll taxes. Employers may also avoid state income tax withholding, unemployment tax, workers' compensation and disability insurance requirements.

In addition, independent contractor status relieves an employer of obligations to:

- Provide employee benefits,
- Pay minimum wages or overtime, and
- Verify a worker's eligibility to work in the U.S. (by completing Form I-9).

From a worker's perspective, independent contractor status is often a disadvantage because he or she is ineligible for certain employee benefits and protections. But, for some workers, the qualified business income (QBI) deduction may provide an incentive



to be treated as a contractor. (See “Independent contractors and the QBI deduction” on page 3.)

Consequences of misclassification

There's a widespread misconception that the IRS and state tax authorities won't challenge the classification of a worker as an independent contractor if the employer files Form 1099 and the worker meets his or her tax obligations. But the reality is that tax agencies would rather deal with employees than independent contractors because it's generally easier to collect taxes from a single employer than from many independent contractors.

If the IRS reclassifies an independent contractor as an employee, harsh consequences may follow. You could be held liable for back taxes — including income taxes that should have been withheld, and both the employer and employee shares of payroll taxes — plus penalties and interest. Notably, you can incur penalties even if the worker met his or her tax obligations as an independent contractor.

In addition to having to pay back taxes, you might also be exposed to claims by misclassified employees for employee benefits, minimum wages or overtime, as well as penalties for failure to meet I-9 requirements.

Independent contractors and the QBI deduction

The Tax Cuts and Jobs Act added Section 199A to the Internal Revenue Code. It allows sole proprietors and owners of pass-through entities who meet certain requirements to deduct up to 20% of their qualified business income (QBI). Because the deduction is available to independent contractors but not to employees, it may provide an incentive for some workers to be treated as independent contractors.

Given the potential loss of tax revenue from both the employer and the independent contractor who claims the QBI deduction, you can expect the IRS and state tax authorities to scrutinize these relationships closely. And think twice before converting an employee to an independent contractor: IRS regulations generally provide that an employee who's subsequently treated as a non-employee while performing substantially the same services is presumed to be an employee, for purposes of the QBI deduction, for three years after the conversion. (This presumption may be rebutted with evidence that the worker is performing services as an independent contractor.)

Issues to evaluate

Whether a worker is properly treated as an employee or independent contractor depends on the facts and circumstances of each case, but certain factors are critical to the determination. The IRS typically examines details within three categories:

1. Behavioral control. Generally, the more control the employer has over what a worker does, and how and when he or she does it, the more likely the worker is an employee. Factors to examine include the level of training and instruction provided, control over when the work is performed, and the existence of performance evaluation mechanisms.



Workers entrusted with key business functions are more likely to be considered employees.



2. Financial control. The more control the employer has over the economics associated with a job, the more likely the worker is an employee. Employees tend to use their employers' equipment, get paid based on the number of hours they work, get reimbursed for their expenses, and

receive paid time off and other perks. Independent contractors typically have their own equipment, pay their own expenses, and can experience profit or loss on jobs. Often, they're paid a flat fee rather than an hourly rate.

3. Nature of the relationship. Employees are more likely to be hired indefinitely and to work for a single employer. Independent contractors are often engaged on a project basis and typically offer their services to multiple customers. Workers entrusted with key business functions are more likely to be considered employees.

Some states have enacted laws that govern the classification of workers. A recently enacted California law, for example, provides that a worker can't be classified as an independent contractor unless he or she performs work that is "outside the usual course of the hiring entity's business" and meets certain other requirements.

An ongoing issue

Whether a given individual is an independent contractor or employee is an ongoing issue that has challenged employers for years. To avoid or minimize liability for back taxes, back wages and penalties, general contractors should regularly reexamine their relationships with subcontractors — especially any used regularly or for long-term projects. Your CPA can help you assess whether you're at risk from the IRS or a state tax authority. ■

Keeping an eye on taxes: the CARES Act and construction

The federal government's response to the novel coronavirus (COVID-19) crisis has included many tax law changes. To simplify matters, let's look at three issues that contractors should keep an eye on in light of the Coronavirus Aid, Relief, and Economic Security Act (CARES Act).

Maintaining payroll

As of this writing, some construction work has been continuing in parts of the country, but many projects have seen slowdowns or shutdowns. To help employers retain their workforces, the CARES Act created a refundable credit against payroll tax.

The credit is generally available to employers whose operations have been fully or partially suspended because of a COVID-19-related governmental shutdown order. Employers whose gross receipts have dropped more than 50% compared to the same quarter in the previous year (until gross receipts exceed 80% of gross receipts in the earlier quarter) are also typically eligible.

Qualifying employers whose workforces exceed 100 employees may claim the credit for employees who've been furloughed or had their hours reduced because of the reasons noted. If an employer has 100 or fewer employees, it can qualify for the credit

regardless of whether it has furloughed employees or reduced employee hours.

The credit equals 50% of up to \$10,000 in compensation, including health care benefits, paid to an eligible employee after March 12, 2020, through December 31, 2020. Note that the \$10,000 limit is per employee. (Additional rules and limits apply.)

The CARES Act also enables employers to delay payment of their share (6.2% of wages) of the Social Security payroll tax. Employers can pay the tax over the next two years, with the first half due by December 31, 2021, and the second half due by December 31, 2022.

Dealing with losses

When a trade or business's deductible expenses exceed its income, a net operating loss (NOL) generally occurs. Many construction companies may incur NOLs as revenue drops while expenses persist.

Before the Tax Cuts and Jobs Act (TCJA), taxpayers could carry back NOLs two years and carry them forward 20 years, to offset taxable income. The TCJA limited the NOL deduction to 80% of taxable income for the year, eliminated the carryback of NOLs and removed the time limit on carryforwards.

Helpfully, the CARES Act allows NOLs arising in 2018, 2019 or 2020 tax years to be carried back five years. Additionally, it removes the taxable income limitation on deductions for prior-year NOLs carried forward into tax years before 2021, so that NOLs can fully offset income. It also removes that limitation for certain NOLs carried forward to tax years after 2020.

Finally, it temporarily eliminates the limitation on excess business losses for pass-through entities and sole proprietors. These taxpayers can now deduct excess business losses arising in 2018, 2019 and 2020 tax years.



Saying bye to the retail glitch

Since passage of the TCJA, the construction industry has been keenly aware of the “retail glitch.” Because of an inadvertent drafting error by Congress, any qualified improvement property (QIP) placed in service after December 31, 2017, wasn’t considered eligible for 100% bonus depreciation. This typically includes upgrades to retail, restaurant and leasehold property.

When drafting the CARES Act, Congress eliminated the glitch. Most businesses can now claim 100% bonus depreciation for QIP, assuming all applicable rules are followed. Better yet, the correction is retroactive to any QIP placed in service after December 31, 2017. (Improvements related to a building’s enlargement, elevator or escalator, or internal structural framework don’t qualify.)

Unfortunately, given the current drag on the U.S. economy, many of the businesses looking to undertake QIP projects may not be able to immediately do so. Nonetheless, in the spirit of optimism, contractors should look for such projects to eventually ramp up.

Learning it all

Construction company owners should familiarize themselves with these and other relevant provisions of the CARES Act — such as those related to expanded Small Business Administration assistance. Also keep in mind that, by the time you’re reading this, additional IRS guidance may have been released or other important relief legislation may have been signed into law. ■

Opportunity zones may increase demand but present risks

T rue to their name, recently created qualified opportunity zones (QOZs) may raise attractive opportunities for contractors. But, before taking advantage, familiarize yourself with the requirements of these projects and be on guard against their potential risks.

How they work

QOZs were established under the Tax Cuts and Jobs Act. They’re designed to attract investment in economically distressed areas by offering tax benefits to those who invest in them through qualified opportunity funds (QOFs). These funds allow investors who have realized capital gains on other assets to reinvest the proceeds in a QOF and defer tax on those gains until the end of 2026 or the date they sell their QOF investments, whichever comes first.

In addition to deferring their gains, investors enjoy a 10% reduction in gain for QOF investments held

at least five years, or a 15% reduction for investments held at least seven years. They also avoid taxation altogether on any post-acquisition gains earned by QOF investments held at least 10 years. However, to receive the maximum 15% gain reduction, one must have invested in a QOF by the end of 2019 in order to meet the seven-year holding period by the end of 2026.

A QOF is a fund that’s established for the purpose of investing in QOZs and meets certain requirements, including holding at least 90% of its assets in “QOZ Property.” Such property includes:

- Direct acquisitions of “QOZ Business Property” — that is, real estate or other tangible property used in a trade or business within a QOZ, and
- Certain equity interests in “QOZ Businesses” that invest primarily in QOZ Business Property and meet certain other requirements.



For a building to qualify as QOZ Business Property, it must, among other things, be purchased by a QOF or QOZ Business after 2017 and meet either an “original use” or “substantial improvement” requirement. To meet the original use requirement, the building must have been new or under construction when bought. Under IRS guidance, used property may meet the original use requirement if it had been vacant for an uninterrupted period of five years or more when purchased.

A building that fails the original use test can still qualify as QOZ property if it’s substantially

improved. Under IRS guidance, that means that the QOF or QOZ Business must more than double the adjusted basis of the building (excluding the land) within 30 months after acquiring it.

Protect yourself

QOZ projects should create new demand for construction services, but these jobs may be risky. This is particularly true for substantial improvement projects, given the time pressure of the 30-month deadline. Building owners anxious to qualify for QOZ tax incentives may attempt to impose tight timelines in their contracts to help ensure that they meet the deadline.

Before signing a contract, assess whether the job’s timelines are realistic and inspect the building carefully to identify potential issues that may delay the project or increase costs. Also, be sure the contract includes provisions that protect you in the event of delays that are out of your control.

Do your homework

If you get the chance to bid on a QOZ project, research the job carefully. You may also want to have an attorney review the contract to ensure its language is fair and reasonable. ■

Have you looked online for skilled labor?

Construction companies continue to face a serious skilled labor shortage. Although demand for qualified workers has been increasing steadily over the last several years, the impact of the Great Recession continues to limit the supply of candidates to fill those jobs — yes, even all these years later. And the short- and long-term effects of the novel coronavirus (COVID-19) outbreak on the industry are still being felt and assessed.

To overcome this skills gap, construction businesses need to take advantage of all recruiting options available, including online job sites.

Source of the shortage

Much of the problem stems from the loss of jobs during the Great Recession. Even though the recession was more than 10 years ago, the Bureau of

Labor Statistics estimated that the construction industry lost more than 1.5 million jobs from December 2007 to June 2009.

Many of the workers who lost their jobs during that period left construction permanently. Some went to work in different industries, others returned to school to change careers and many retired. So, though demand to fill these lost jobs is high, candidates to fill them haven't been easy to find.

Strategies to consider

There are many long-term strategies for finding the talent you need. You could partner with local high schools, community colleges and trade schools to establish internship and skills certification programs. Internally, you might undertake new initiatives to “upskill” current workers and attract new ones. Your company may also be able to better take advantage of job fairs, temp agencies and recruiters with experience in the construction industry.



Now could be a good time to connect with job candidates online and gather their information.



But, if you're looking for a more immediate solution, online job boards are particularly valuable. Because many of the workers who left the industry in the wake of the recession were older, and many Baby Boomers have since retired, today's jobseekers tend to be younger and more likely to conduct job searches online.

There's no shortage of websites to check out. The right ones will depend on distinctive aspects of



your business, such as its location and specialty. Here are a few places to start:

- [ConstructionJobs.com](https://www.constructionjobs.com),
- [iHireConstruction.com](https://www.ihireconstruction.com),
- [CareersinConstruction.com](https://www.careersinconstruction.com),
- [ConstructionJobForce.com](https://www.constructionjobforce.com),
- [Roadtechs.com](https://www.roadtechs.com), and
- [GeneralConstructionJobs.com](https://www.generalconstructionjobs.com)

These sites focus on construction jobs, but you may also find good candidates on general job boards, such as [Indeed.com](https://www.indeed.com), [ZipRecruiter.com](https://www.ziprecruiter.com), [Glassdoor.com](https://www.glassdoor.com), [Monster.com](https://www.monster.com) or even [Craigslist.com](https://www.craigslist.com).

A difficult time

Like so many companies, yours may be struggling to adapt to the economic changes wrought by the COVID-19 outbreak. You might have put hiring plans on hold indefinitely. However, now could be a good time to connect with job candidates online and gather their information, so you can touch base with them when conditions improve. ■

Helping Contractors Build Success

Succeeding in the construction industry takes smart bidding, quality work, savvy management — and the assistance of advisors who know the business and can help move your company ahead.

Martin Hood LLC excels in helping construction businesses build their success. We offer a full range of tax, audit, accounting, business consulting and financial planning services tailored to the unique needs of the construction industry.

Our experienced professionals are dedicated to delivering timely, accurate and personalized service that meets the highest standards of quality and integrity. As a result, we have built a strong reputation for helping construction businesses like yours increase their profitability and success.

We are ready to help you with a broad range of tax, accounting and business management issues, including:

- Accounting systems and controls
- Project bidding and estimating
- Change orders and closeouts
- Cost segregation studies
- Tax planning and filing
- Estate and succession planning
- Bonding and financing
- Job costing and project management

We would welcome any questions you may have on the topics discussed in this newsletter or on other issues affecting your business. Please contact our office at 217.351.2000 and let us know how we can be of assistance.