



## BONDING

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### Prepare Now for 2010

By Trip Farmer, CPA, CCIFP | HHM

As the year winds down, many are preparing to enjoy the approaching holiday season; however, contractors are generally working harder than ever to finish up jobs and sign new contracts. Preparing for the year-end financial statement is likely more important this year than in past years due to the many challenges in our economy, especially in real estate and construction.

Preparing for year end means balancing tax planning opportunities with financial statement strength. Sureties and lenders are particularly focused on the financial strength of the company and owners for purposes of bonding capacity. Bonding capacity cannot be over emphasized going into 2010 for contractors to survive.

So what do you need to consider in shoring up the company for surety sake?

Maximize adjusted working capital - maximizing cash and accounts receivable while keeping accounts receivable under 90 days.

Sureties adjust the working capital calculation and discount inventory, prepaids, and underbillings - these assets should be minimized as appropriate.

Converting short-term debt to long-term debt improves working capital ratios by reducing short-term obligations.

Good contractors overbill their jobs, using the customer's cash flow as an interest free loan. Large underbillings can point to problems jobs with inaccurate estimated costs and possible cost overruns.

Maximize equity and keep debt-to-equity ratios conservative.

Reconsider large fixed asset purchases - while there may be tax benefits to these purchases, sureties and lenders are taking a closer look at idle equipment, values of equipment where book value is higher than liquidation value, the carrying cost burden of maintaining equipment, and any increases in debt obligations.

Unapproved change orders need to be approved - do not let these slip through the cracks.

Review depreciation methods on equipment. Consider useful lives and salvage values.

Do not let your construction company become an investment company - owners should keep their investments in other companies, real estate, and any development activities separate from their contracting company (this creates uncertainty for sureties and they do not like uncertainty).

Sureties are still keeping to the basics of the three Cs in their underwriting - Character, Capacity, and Capital - but a tightening of the market means the weak will fail and the strong will survive. Planning for 2010 starts with finishing well in 2009...start today.

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## TENNESSEE PASSES LEGISLATION ON BUSINESS TAX FILINGS

By Kevin Lusk, CPA | HHM

Recently passed legislation in Tennessee will change the way businesses file their local business tax returns. For most construction contractors registered in Tennessee as a Classification 4, this change will be in effect for returns due November 30, 2010, so you have 1 year to prepare.

Beginning in 2010, the new law will change the way that business tax is collected. Business taxes will be filed with the Tennessee Department of Revenue, instead of the county clerk and/or city official. Under the new law, businesses that are filing sales and use tax returns and make payments electronically will also be required to file the business tax return electronically and remit business tax payments electronically, using a method approved by the Commissioner of Revenue. A business license will continue to be handled by the local county clerk and/or city official, but once the law takes effect, it will be mailed to you automatically upon filing and payment of your taxes to the Tennessee Department of Revenue.

The tax rates will remain unchanged, as well as the requirement for businesses operating within Tennessee city limits to file two business tax returns for that location – one return for the city and one return for the county.

In addition to the new filing requirements, there are additional changes beginning in 2010 specifically for construction contractors. These new changes include:

- Contractor's Deemed Location – If a contractor earns more than \$50,000 in a location outside the contractor's city and county of domicile, then it must obtain a business license and file a return for that additional location.
- Subcontractor Deduction – The business tax return allows a deduction for payments to subcontractors. Starting in 2010, this deduction can be taken only when the subcontractor holds a valid business license or a contractor's license. A contractor must remit an attached form along with the business tax return that includes the subcontractor's name, address, business license or contractor's license number, and the total amount paid. Additionally, a contractor is required to maintain in its records a copy of the subcontractor's license.
- Personal Property Tax Credit – The personal property tax credit can offset up to 50% of the total business tax liability (down from 100%).

The 2009 Tennessee Classification 4 Business Tax renewal forms, which are due on November 30, 2009, will still be filed with your local county clerk and/or city official. The new 2010 forms will be available at the Tennessee Department of Revenue website later this year.

In preparation for these new changes:

Begin to collect the business tax license numbers or contractor's license numbers from your subcontractors.

Maintain job revenues/costs for locations outside of your domicile to more easily comply with the new deemed location filing requirement.

Obtain a business license in each location where gross revenues exceed \$50,000. Having this information readily available will simplify compliance with the new filing requirements when they become effective in November 2010.

As with any new tax legislation, please check with your tax advisor to help you implement any new requirements, and to be sure you are aware of the latest tax changes.

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## ARE YOU CONSIDERING ALL APPLICABLE TAXES AND FEES WHEN BIDDING WORK IN FOREIGN STATES?

Blake Callahan, AVA | HHM

In today's construction market more and more contractors are entering new states for new sales opportunities. In response to increased competition, contractors are seeking opportunities in foreign states in order to survive the economic downturn. Before a contractor prepares a bid in a foreign state they should be well aware of the applicable registration requirements, taxes, and possible fees of that particular state. Not understanding these state specific costs could result in a surprise once a job is completed and turn an anticipated profit into a loss. Prior to 2008, the average number of bids for a construction bid job was between 5-10 bids per job. Today the industry is seeing construction projects with as many as 20 or more bids. Whereas most bids are very competitive, often times 1 or 2 contractors bid much lower or much higher. This may be due to not understanding all of the state specific requirements. Not correctly accounting for the particular taxes and fees of other states could result in a

bid ending up too high and the contractor not winning the bid, or too low and the contractor potentially losing money on a completed contract. A common mistake made by contractors is preparing a bid using the fees and taxes applicable to the contractor's home state. If this mistake is made, a bid may be incorrectly priced, depending on how the tax structure of your home state compares with that of the foreign state. Contractors should be aware of all taxes, fees, and registration requirements when considering work in foreign states. Corporations must obtain a certificate of authority in order to do business in a particular state. Taxes and fees that contractors should be aware of include income tax, annual corporation franchise tax, corporation excise tax, sales and use tax, business tax, local option taxes, and even fuel taxes. Failure to consider any one of these taxes could cause a major fluctuation in the bid. For example, a Tennessee general contractor bidding on a job in Alabama would be subject to an annual privilege tax; an income tax of 6.5%; a sales tax of 4.0% on certain building and construction

material; a gross receipts tax of 5.0% if the contract was for the construction of any public highway, road, bridge or street; a fuel tax rate of 12 cents per gallon; and possibly a local tax depending on what Alabama city/county the project is in. This is a great deal to consider. To break down the above example, consider the following information on a contract:

Bid amount:	\$1,500,000
Materials purchased:	\$500,000
Equipment to be used:	\$100,000
Gas for equipment:	1,500 gallons
Estimated Gross Profit:	6% (\$90,000)

	ALABAMA	TENNESSEE	DIFFERENCE
Franchise Tax/Privilege Tax (Based on income or equipment)	\$90	\$475	(\$385)
Sales Tax	\$20,000	35,000	(\$15,000)
Fuel Tax	\$180	\$300	(\$120)
Excise Tax/Income Tax	\$5,850	\$5850	\$0
Business Tax/Gross Receipts Tax	\$0	\$1500	(\$1500)
<b>TOTAL</b>	<b>\$26,120</b>	<b>\$43,125</b>	<b>(\$17,005)</b>

At first glance the \$17,005 cumulative difference in using Tennessee tax rates versus Alabama tax rates may seem insignificant on a \$1.5 million dollar project. Consider if the winning bid was \$1,490,000; only \$10,000 less than this bid of \$1,500,000. Now the \$17,005 difference becomes more relevant. This contractor just missed out on \$90,000 of estimated profit because the applicable state taxes were not properly considered in the bid process. A mistake in any one tax, such as sales tax, may mean a significant difference in the net profit or loss on a job. The \$15,000 difference in sales tax may mean the difference in winning the bid.

This example only considers the tax differences for one project in a foreign state. The consequences of failing to consider the applicable state taxes could be magnified if multiple projects are involved or if projects are being bid in multiple states. Also, the above example does not consider the possible local city and county taxes that may apply. Every state's tax structure is different. Crossing state lines requires attention to all state specific rates. This awareness could mean the difference in getting jobs and making them profitable.

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