



CONSTRUCTION INDUSTRY ADVISOR

Group captive insurance may suit construction companies

Read up on DBA rules before bidding on public jobs

Launching a venture as a limited partnership

Is now the time to invest in electric vehicles?



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Group captive insurance may suit construction companies

Construction is a highly competitive industry notorious for its razor-thin profit margins. That's why it's important for contractors to identify every possible way to reduce costs, generate income and minimize losses.

A group captive insurance arrangement may help with all three of those points by reducing your construction business's insurance expenses, allowing you to share in the captive's profits and enhancing your risk management efforts. Naturally, there are some administrative burdens and risks to consider.

What's a group captive?

A captive is simply a licensed insurer owned and operated by the companies it insures. Captives can take several forms, but let's focus on *group* captives, which are the most common arrangement for small to midsize construction companies to participate in.

True to their name, group captives are formed by groups of similar companies — such as businesses in a certain industry or members of a trade association — to serve the insurance needs of their members. Although participants may replace their existing commercial insurance with the captive's coverage, members more commonly use captive insurance as supplemental coverage.

The members own and operate the captive, paying premiums to cover operating expenses and fund a cash reserve for losses. They also share in the captive's profits and investment income.

How do taxes work?

Although a group captive is essentially a form of self-insurance, members may deduct their premiums as a business expense in the same way they would

deduct premiums paid to a commercial carrier. Underwriting profits, if any, are free of tax until they're distributed to members. So-called "microcaptives" may enjoy an additional tax benefit, though the IRS is highly suspicious of these arrangements. (See "IRS targeting microcaptives" below.)

To be eligible for these tax benefits, a captive must qualify as an "insurance arrangement" for federal tax purposes. That means:

- Members must shift risk to the captive, and
- Risk must be distributed among enough unrelated parties to minimize the chances that a single loss would deplete its cash reserves.

Whether risk is sufficiently distributed depends on each group captive's distinctive facts and circumstances, and a full discussion of the factors considered is beyond the scope of this article. Generally, however, a captive that insures only its

IRS targeting microcaptives

A microcaptive is a particularly small captive insurer that may enjoy a particularly enticing tax benefit. That is, it can elect to be taxed only on its net investment income, not on its premium income. Generally, microcaptives are defined as those whose annual premiums don't exceed an inflation-adjusted threshold (\$2.8 million in 2024) and meet certain diversification requirements.

However, smaller group captives that meet these requirements should think carefully before making the election. The IRS has been closely scrutinizing microcaptives and challenging those it views as mere tax avoidance schemes. It's particularly interested in microcaptives involving purported insurance contracts between related parties.



parent company probably wouldn't be considered an insurance arrangement. On the other hand, a captive that receives 50% or more of its premiums from businesses unrelated to the parent would likely qualify as one.

How do members benefit?

Under the right circumstances, a properly created and managed captive can provide a number of benefits. These may include:

Cost savings. Coverage through a group captive typically offers lower, more stable premiums than comparable policies with commercial insurers. One reason for this is that commercial premiums include a significant markup to cover the insurer's expenses and profit margin.

Another reason is that the best group captives require members to meet certain risk management standards. Thus, these captives tend to experience fewer losses than the overall insurance market, resulting in lower premiums. In addition, group captives have direct access to the wholesale reinsurance market for protection against catastrophic losses, allowing them to control their expenditures.

Tailored coverage. Because members control the captive, they can tailor coverage to meet their specific needs and avoid paying for unneeded insurance. They may also be able to obtain coverage for risks not typically insured by traditional carriers, often at higher limits and with fewer exclusions.

Potential income. Group members participate in the captive's underwriting profits. This provides

an additional incentive for members to implement risk management best practices to help minimize claims. In addition, captives typically invest their reserves and surpluses, generating investment income for members.

More control over claims. As owners of the captive, group members have a great deal of control over the claims review and approval process.

Stronger operations. Given the importance of minimizing losses, best-in-class group captives generally require members to demonstrate strong risk management practices and a firm commitment to worker safety and wellness as a condition of acceptance.

This provides an incentive for members to share best practices for reducing losses from accidents and illnesses. Such collaboration not only reduces costs and enhances profits, but also helps participants retain employees and improve their business reputations.

Disadvantages

Like most business strategies, a group captive insurance arrangement has challenges and disadvantages to consider. Joining a captive may involve an upfront investment of capital. From there, group captives impose considerable administrative burdens on members, including compliance with insurance regulations.

They also require members to develop insurance industry expertise and share control of the captive with other members. And it's worth noting that membership in a group captive could complicate a merger or acquisition.

A major decision

Make no mistake, the decision to join a group captive is a major one wrought with complexities and risk. If interested, be sure to discuss the concept at length with your leadership team and professional advisors. ■

Read up on DBA rules before bidding on public jobs

If your construction business plans to bid on a publicly funded project, it's important to understand your obligations under prevailing wage laws. This includes the federal Davis-Bacon Act (DBA) and the "little DBAs" adopted in most states.

These laws require contractors to pay most workers on public projects wages that are comparable to wages for similar work in the same geographical area. So, to prepare accurate bids on such jobs, it's critical to get a handle on what your actual labor costs will be.

It's also important to read up on the latest rules. Recently, the U.S. Department of Labor (DOL) overhauled its regulations governing federally funded projects subject to the DBA. The new rules, which apply to contracts entered into after October 23, 2023, are expected to increase wages on most jobs and impose harsher consequences for noncompliance.

Determining prevailing wages

Under previous rules, contractors would determine the prevailing wage for a particular worker

classification by ascertaining whether most of those workers — that is, more than 50% — received the same wage rate. If so, that rate would be the prevailing wage. If not, the prevailing wage would be based on a weighted average of all wage rates paid to those workers.



The new rules are expected to increase prevailing wages in many cases.



The new rules reinstate the method used before 1982 for determining the prevailing wage. Under this method, contractors still begin by ascertaining whether most workers in a classification receive the same wage rate. If they don't, the prevailing wage is based on the rate received by at least 30% of those workers. If no wage rate is received by at least 30% of workers, then the prevailing wage is based on a weighted average of all wage rates paid to those workers.



Ultimately, the new rules are expected to increase prevailing wages in many cases.

Calculating fringe benefits

Generally, prevailing wage rates consist of a base rate paid in cash and a fringe benefit amount. Contractors have the option of paying fringe benefits in cash or by applying fringe benefit credits for contributions to "bona fide" benefit plans — such as health

and life insurance, long-term disability plans, retirement plans, or vacation days or other paid time off. Often, meeting the fringe benefit obligation by contributing to benefit plans is more cost-effective than paying them in cash.

The new rules codify a long-standing “annualization” principle. Under this principle, the DOL requires DBA credits for benefit plan contributions (with certain exceptions) to be based on the effective annual rate of contributions for all hours an employee works during the year on both DBA and non-DBA projects. The impact of this requirement, in many cases, will be to reduce fringe benefit credits on DBA projects, requiring the contractor to make up the difference with higher cash payments.

Expansion of DBA coverage

The new rules expand the reach of DBA coverage in several ways. For example, the act extends to certain secondary construction sites, such as pre-engineering or modular construction sites, related to DBA projects. It also applies to energy infrastructure projects; jobs involving portions of a building; and certain demolition, remediation and removal activities.

In addition, the rules extend coverage to certain off-site flaggers, truck drivers and survey crew

members. And they narrow the definition of “material suppliers” who are exempt from DBA requirements. Material suppliers who also perform construction work at a DBA site are subject to the prevailing wage requirements.

Handle with care

Be sure to understand your construction company’s DBA obligations before undertaking a federally funded project. The consequences of noncompliance can include:

- Fines,
- Contract termination,
- Debarment (exclusion from future government work), and
- Withholding of contract payments (even on unrelated federal jobs).

The new rules also contain antiretaliation protections for whistleblowers who report suspect payment practices. And for any projects funded by a state government, determine whether a “little DBA” is in place — its rules may have been updated to conform to the DOL’s new regs. Consult a qualified attorney when making these assessments. ■

Launching a venture as a limited partnership

Construction is indeed an industry of opportunity. With infrastructure jobs popping up across the country and manufacturing undergoing a building boom of sorts, contractors have options for winning jobs and making 2024 a year to remember. Maybe that means starting up a new business

or launching a subsidiary of your company. If you go either route, you’ll need to choose an entity type. One to consider is a limited partnership.

Partner roles

Under a limited partnership, a least one general partner runs the business while at least one limited



partner contributes only capital and doesn't participate in management. It can be an excellent entity choice for launching a new venture because it allows the general partners to manage and operate the construction business as they see fit with little intervention from the other partners.

Meanwhile, equity capital is raised from investors, who receive limited partnership interests in exchange for their contributions. As limited partners, they'll share the entity's earnings without having to manage the company or risk personal liability for its activities.

Both sets of partners must exercise care to ensure that the limited partners don't inadvertently lose liability protection. Merely consulting generally doesn't trigger personal liability so long as the general partners remain the clear decision-makers. A limited partner may become personally liable by taking certain actions, such as guaranteeing a partnership debt.

Risk management

One drawback to a limited partnership for general partners is they're personally liable for the entity's debts. This is the price of admission that general partners must pay in exchange for the right to control the operations and strategic direction of the enterprise.

However, there are ways to manage the risk of liability. For example, a corporation may be created to manage the partnership and serve as general partner. Another possibility is to procure adequate insurance to cover potential liabilities arising from operating the business.

Tax considerations

Because a limited partnership is a pass-through entity for tax purposes, partners must include their respective shares of income, deductions, credits and losses from the construction business on their individual federal tax returns.

The good news is, subject to various limitations, partners may qualify for the Section 199A "pass-through" tax deduction to the extent the income passed through to them is "qualified business income" under the tax code.

Had the partners decided to form a C corporation instead of a limited partnership, they wouldn't qualify for this deduction and their earnings would be taxed at a higher effective tax rate. This is because they would be taxed once on the corporation's earnings and again when those earnings were distributed to shareholders.



Both sets of partners must exercise care to ensure that the limited partners don't inadvertently lose liability protection.



With proper planning, a limited partnership can be structured to provide special allocations of various tax benefits that make the venture more attractive to prospective investors. For this reason, a limited partnership may be a better choice for some new ventures than an S corporation. To pass muster with the IRS, however, special allocations must have what's known as "substantial economic effect."

Optimal decision

To be clear, there are plenty of other entity choices you can consider when launching a new construction business. Consult your CPA and attorney to make the optimal decision. ■

Is now the time to invest in electric vehicles?

As the United States, and indeed the world, shifts toward clean energy, most construction businesses will need to contemplate converting their fleets to electric vehicles (EVs). Whether your company should start investing in EVs now or in the near future will depend on a careful analysis of the costs vs. benefits.

Potential benefits

So, why go electric? The first reason is perhaps the most obvious: Using EVs should lower fuel costs for your construction business — depending on how many gas-powered vehicles, and how much gas-powered equipment, you continue to use. In addition, given that they have far fewer mechanical parts than traditional vehicles, EVs tend to have lower maintenance costs and fewer breakdowns.

Another reason may also be obvious but is still important to consider. Deploying EVs will generally reduce your construction business's carbon footprint. That's not only good for the environment, but also may appeal to customers, job candidates, investors and the community in which you operate.

Tax incentives

Tax credits and other incentives can greatly enhance your return on investment in qualified EVs. For example, the federal commercial clean vehicle credit allows you to claim up to \$40,000

per vehicle for qualified commercial clean vehicles with a gross vehicle weight rating (GVWR) of 14,000 pounds or more, and \$7,500 for eligible vehicles with a GVWR of less than 14,000 pounds. The credit equals the lesser of:

- 15% of your basis in the vehicle (30% if the vehicle is completely electric), or
- The vehicle's incremental cost, defined as "the excess of the purchase price of a qualified commercial clean vehicle over the price of a comparable [gas or diesel fuel-powered] vehicle."

To qualify for the credit, EVs need to meet various requirements. They must be subject to a depreciation allowance, be made by a qualified manufacturer as determined by the IRS and be used primarily in the United States for business purposes rather than held for resale. Eligible EVs need to meet certain battery capacity standards as well. In addition, they must be:

- Manufactured primarily for use on public streets, roads and highways, or
- Properly classified as "mobile machinery," which includes vehicles designed specifically to transport specialized construction machinery.

Other rules may apply. Bear in mind that tax incentives may also be available for the installation of EV charging equipment on your property.

A major investment

Acquiring multiple EVs for business use will be a major capital investment for your construction company. So, if you're considering it, ask your CPA to help you weigh the relative costs and benefits, as well as to assist you in identifying all available tax incentives. ■





LAPORTE

CPAs & BUSINESS ADVISORS

111 Veterans Memorial Blvd, Suite 600 | Metairie, LA 70005-3057
504.835.5522 | FAX 504.835.5535

Improving Construction Project Outcomes Through Proper Jobsite Management

Construction leaders know that project successes rely on the proper management of both the jobsite and the back-office. This article delves into improving efficiencies at the jobsite. The following best practices will lay the ground work for a successful construction project.

Implement Physical Security Measures

To properly manage your job, you must protect your assets. You can safeguard your company's physical assets in some of the following ways:

- Install fencing to the jobsite with a limited number of access points, or geofencing if traditional fencing is not an option.
- Use site access control systems to restrict access to jobsites.
- Install surveillance systems.
- Keep jobsites illuminated.
- Hire security guards to protect high-value equipment.
- Install GPS trackers on heavy equipment and/or track who uses it.
- Register your heavy equipment in case of theft.
- Perform regular site inspections.

Improve Relationships with Third Parties

Your business's success is not fully within your control; when third parties like suppliers, subcontractors, or trucking companies fall out of line, your business could suffer. A great control mechanism is to simply improve the relationship you have with these third parties. Have open lines of communication to ensure they're aware of your expectations and you're kept in the loop if something goes awry. You can also do some of the following:

- Create robust contracts that detail expectations and benchmarks.
- Have a centralized communication system so all conversations are recorded for posterity.
- Regularly audit invoices from third parties to catch any discrepancies.
- Provide timelines for deliverables.
- If a relationship sours or quality of work is not as expected, foster new relationships.
- Invest in software that tracks subcontractor performance and provides real-time updates.

Stay Lean

"Staying lean" is operating with only what you need and cutting everything you don't. It means:

Minimizing Losses

You can do this by:

- Improving the accuracy of your projections so your materials orders are more accurate.
- Preventing theft by performing background checks, performing informal spot-checks on back-office tasks, auditing the financials, creating a whistleblower policy, training employees to spot theft or fraud, and properly segregating duties.
- Using technology to sweep the internet for different suppliers or discounts.
- Negotiating with third parties for discounts in exchange for different payment terms.

Eliminating or Reducing Bottlenecks

You can do this by:

- Checking that the order is complete and up to specifications when materials are delivered, even if those materials won't be used right away
- Tracking the arrival of key building products so you can get workers to the jobsite exactly when needed
- Introducing software that will track inventories and automatically reorder when stocks are depleted
- Using software to help you allocate key resources so all projects are covered and moving forward

What other controls are we missing?

There are many more internal controls you can implement to improve jobsite efficiencies; we've only touched on a handful today. If you don't have a robust control environment already in place, doing so can help your projects progress more smoothly and can help improve the financial outcome. Contact a member of LaPorte's Construction Industry Group if you would like to discuss your control environment.