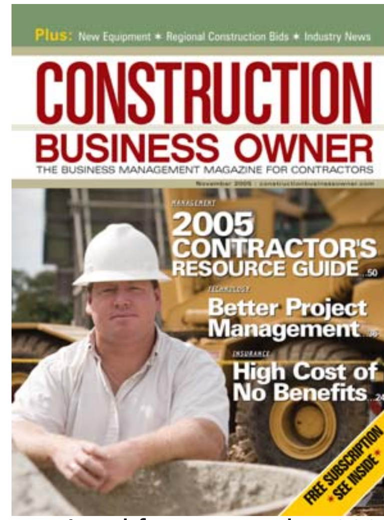
THE HIGH COST OF NO BENEFITS



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By C. Ray Smith

EMPLOYEES COVERED BY THE PROVISIONS OF THE DAVIS-BACON ACT MUST BE:

- **Employees of a contractor or subcontractor**
- **Laborers or mechanics**
- **Performing on the "site of the work"**
- **Paid weekly**
- **Paid the prevailing wage rate regardless of any contractual arrangement, such as an independent contractor or owner-operator relationship**

"I don't understand why any open-shop contractor who does prevailing wage work would NOT have a fringe benefit plan in place. It just doesn't make good business sense."

Bonding agent Joe Weber of John O. Bronson in Sacramento, CA, admits he is "passionate" about making sure open-shop contractors understand the importance of having a benefit package in place for their employees. "I've been in the surety bond business for thirty-five years," he continues, "I've seen the positive effects over and over again. I tell my contractors, 'Every dollar saved flows right to your bottom-line.'"

So why would a contractor forego offering benefits on prevailing wage work? Primarily because of misunderstandings about the prevailing wage laws and the amount of work implementing a fringe benefit plan might entail. Many contractors are passing up significant savings on their payroll costs simply because the requirements surrounding benefits for prevailing wage jobs seem overwhelming or confusing. However, companies that specialize in these benefit packages can put a plan into place with little or no time or work required from the business owner.

A Little History...

To provide some background and insight into the prevailing wage arena, it's helpful to start at the beginning. The *Davis-Bacon Act* took effect in 1931 in an effort to protect communities and workers from the economic disruption caused by non-local contractors coming into an area and winning federal construction contracts by underbidding local wage levels. The Act requires payment of locally "prevailing wages" and fringe benefits to laborers and mechanics employed on direct federal contracts in excess of $2,000 for construction, alteration or repair (including painting and decorating) of public buildings or public works. Examples of projects that would be subject to the provisions of the Davis-Bacon Act are General Services Administration contracts to build federal office buildings or Department of Defense contracts to build military housing.

The statute requires contractors and subcontractors to pay "all laborers and mechanics employed directly upon the site of the work, unconditionally not less often than once a week, and without subsequent deduction or rebate on any account, the full amount accrued at the time of payment, computed at a wage rate not less than those in the advertised specifications, regardless of any contractual obligation which may be alleged to exist between the contractor or subcontractor and such laborers and mechanics."

In layman's terms, employees covered by the provisions of the Davis-Bacon Act must be:

- Employees of a contractor or subcontractor
- Laborers or mechanics
- Performing on the "site of the work"
- Paid weekly
- Paid the prevailing wage rate regardless of any contractual arrangement, such as an independent contractor or owner-operator relationship

The Davis-Bacon Act requires contractors working on federally-funded projects to pay its employees a prevailing wage including the "anticipated cost of prevailing benefits." This is generally expressed as a per-hour wage and per-hour cash equivalent value of benefits and is often based on a union scale. Prevailing wages are set by the U.S. Department of Labor and are included in the bid specifications of covered contracts.

As an example, a contractor may bid on a federally-funded job which stipulates that laborers are entitled to a $16 per hour cash wage and $4 per hour in fringe benefits. Under the Davis-Bacon Act, employers can either choose to pay the fringe benefits as additional cash wages (which would result in an effective hourly wage of $20) or provide a "bona fide" benefit plan. Benefits that might be included in such a plan are retirement accounts (401 (k) or pensions), medical insurance, vision insurance, dental insurance and life insurance.

Cash or Bona Fide Benefit Plan?

Many contractors choose to pay the fringe portion of the prevailing wage in cash believing it's the simplest way to comply with the law. But choosing this option is an extremely expensive way to comply. It doesn't allow employers to realize the considerable cost-savings of providing their employees a bona fide benefit plan, and the plan also works to the employees' advantage in the long run.

The reason choosing the cash option is so much more expensive is that all cash wages paid to workers are subject to payroll taxes such as FICA, FUTA, state unemployment taxes and Worker's Compensation. Although there are variances in the rates of the latter two, the additional cost to employers for these taxes is typically around twenty-five cents on every dollar paid in wages. Simply by providing employees a bona fide benefit plan, the contractor can reduce payroll costs by the same amount, while also helping employees secure their futures.

Patrick McClanahan owns McClanahan Construction in Springfield, MO. He recently implemented a benefit plan for his employees and wishes he had made the decision sooner. "My company hasn't done a non-prevailing wage job in the past five or six years but prior to this year we paid the fringe portion of the prevailing wage as additional cash wages," he says. "I look back at how much we could have saved and it's kind of staggering."

Contractors interested in learning how much they could save can access an online calculator at www.fibi.com. The calculator allows contractors to input their own payroll figures, number of employees and dollar amount of fringes to get personalized estimates on the savings they could realize.

McClanahan made the decision to begin providing a bona fide benefit plan for his employees after meeting John Allen of the Fringe Benefit Group at the World of Concrete trade show. "To be honest, I'd talked to someone else about this issue. But then I met John and was really impressed with his knowledge and follow-through," McClanahan says.

He admits he had many of the same concerns as other contractors about starting a benefit program. "I put John in contact with my CPA and made it clear that I didn't have a lot of time to spend either setting this thing up or making sure it was running right," McClanahan says. "I couldn't believe how easy it was and how little of my time it actually required."

Tom Mechsner, McClanahan's CPA, admits it had "been awhile" since he'd worked with a prevailing wage benefit program. "The concept made so much sense economically for Patrick's business," Mechsner says. "And while I've been a CPA for many years, I didn't have much prior experience with this kind of plan."

As a result, Mechsner and his payroll

professional, Kathy Iman, had several questions about setting up the plan and ensuring it ran correctly once implemented. “We were so impressed with how quickly we got responses from John,” Mechsner says. “If he didn't know the answer, he put us in touch with the right person at Fringe."

Iman says after the plan was set up, Allen checked in with her from time to time to make sure everything was running smoothly. “That almost never happens,” she says. “The whole process was so easy, and John really worked with us to customize the program.”

The Business *and* the Employees Benefit

McClanahan admits the biggest selling point for implementing the plan is the bottom line. “In our area of the country, the fringe portion of prevailing wages can be as high as 25-30 percent of pay. Reducing our tax burden on that portion of payroll is a huge savings.”

He says as a rule, base wages have stayed fairly consistent over the past few years, but the amount allocated for fringe benefits continues to increase, providing even further incentive to set up a benefit plan for his workers.

CPA Tom Mechsner adds that while McClanahan was excited about the cost savings he could realize, that wasn't his only reason for putting a benefit plan in place. “Patrick was really thinking about his employees,” Mechsner says. “He saw this not only as a way to make his business more cost-efficient, but also as a way to help his employees in the future.”

“Workers in this industry are notoriously bad about planning for their futures,” McClanahan says. “It can lead to some really sad situations. A lot of what we do is very physically demanding, and people just can't do it forever. One day their body gives out, this is all they've done their whole lives, and they haven't saved a dime. It's heartbreaking.” Especially with higher-earning workers, the potential for accumulating a significant retirement nest egg is substantial. “If the employee gets any kind of rate of return at all,” McClanahan says, “he's going to have a significant amount of money at retirement.” Workers are immediately vested in the retirement plan and can access their accounts immediately upon leaving the employer or retiring.

Some contractors shy away from switching to offering benefits as opposed to additional cash wages because they've heard horror stories about workers “jumping ship." McClanahan says he'd heard those stories, but asked a colleague who had made the change about three years ago if it was, in fact, a problem.

“My friend told me that the first year of the plan, his workers hated it. It's human nature—you're used to bringing home a certain amount of money every week, and then all of a sudden you bring home less,” he says. “But after the first year, the employees love it. They see the money accumulating in their 401(k) plans and start to realize the value.” McClanahan says he's lost one worker, but believes offering benefits has actually helped him attract and retain more highly-skilled workers.

Employers who do not offer benefit plans actually have trouble attracting skilled laborers, which usually results in an indirect increase in costs. Untrained laborers learn their skills on the job, taking longer to complete tasks and often making mistakes that more experienced workers would not.

Craig Alper owns Alper Enterprises, a roofing company in Moorestown, NJ. Since his company specializes in historical restorations, his workers must have a unique set of skills—making employee retention especially critical. He feels providing a good benefit package is one of the keys to his high employee retention rate.

“With the niche type of business we do, my workers have to be highly skilled in three or four different areas that all kind of get categorized as 'roofing,'” Alper explains. “We do very high-quality work, as opposed to just production.” Alper says the very specific training needed for a laborer to be fully competent to perform to his standards can easily take four years and an investment of at least $10,000 per year.

Alper says he realizes some companies treat their workers as “disposable” and aren't bothered by high turnover, reasoning it means they don't have to pay higher wages. “But even if I didn't require such highly-skilled craftsmen, I wouldn't operate my business that way,” Alper states. “It's so self-defeating in the long run.”

Alper says his goal is to provide his employees with more job security, as well as providing them with a reason to take pride in their work and stay with the company. “If I can help my employees in ways they're not accustomed to,” he says, “I think I have a social responsibility to do so. I owe that to my employees for helping to make this company successful.”

“It's a win-win situation,” concurs bonding agent Joe Weber. “The contractor wins and the employee wins.” He adds that he often tells contractors that if they don't have a benefit plan in place, they're just giving money away. “I ask them who they'd rather give money to—the government or their employees. Once they see how much they can help their employees—as well as how the cost savings improve their income statement and balance sheet—they realize what a good thing this is.”

As a simple example, a contractor who has a payroll of $400,000 in a year of prevailing wage work could realize savings of as much as $25,000 in taxes by choosing to provide a bona fide benefit plan rather than pay the fringe benefit amount to the employee in cash. “Adding that to the bottom line makes the company look much healthier financially. That means we can bond them for larger amounts, which in turn means the company can go after bigger projects," Weber explains.

John Mielke is the director of government relations for the Wisconsin Chapter of the Associated Builders and Contractors. Like Weber, he refers to himself as "passionate" about helping contractors understand prevailing wage laws. Mielke says there are two areas that create most of the confusion contractors face—one that exists regardless of whether the contractor is providing fringe benefits or paying additional cash wages and the other that directly pertains to the savings realized by offering fringe benefits over paying additional cash wages.

"The first issue is job classification," Mielke explains. "In Wisconsin, for example, we have very detailed job descriptions outlining what each class does. But in a merit shop, you may have a worker who spends most of his time as a carpenter, but occasionally does other labor as well. If he spends more than an 'incidental' amount of time on the other work, he has to be paid for those hours at the rate specified for the other job classification." Mielke says there are provisions that allow for some cross-classification, but the issue can be difficult to document.

The second area that can be complex is helping contractors, who currently offer some benefits, determine how those benefits apply toward fulfilling the bona fide benefit plan provisions of the prevailing wage laws. Mielke gives this example: "Sometimes a contractor who wants to provide benefits for their prevailing wage work is already offering health insurance or life insurance. The issue then becomes determining how the premium the employer pays—which is likely different for each employee—applies toward fulfilling the fringe benefit allocation in the prevailing wage for the job."

John Allen, Midwest sales director for Fringe Benefit Group, encountered this very issue when he worked with McClanahan Construction. "This is something we often help contractors with," he says. "We worked with McClanahan's health insurance agent, Bill Southworth of Barker, Phillips, Jackson, to not only analyze how the premiums that were being paid would apply toward fulfilling the fringe benefit amount, but to ensure the employer was properly taking credit for those premiums."

McClanahan says he especially appreciates that paying the employee's share of the premiums with pre-tax dollars saves the employee money, as well as saving money for the company as a whole.

Allen explains that in situations such as McClanahan's, the amount the employer is paying for health insurance premiums might account for a third of the benefit amount specified in the prevailing wage, and his role is then helping the contractor determine the best use of the remaining dollars in the fringe benefit specified. "While we do offer a good health insurance product, if a contractor is satisfied with their current provider, we're happy to work with them," he says.

Mielke says he often sees contractors simply paying the remaining amount of the fringe in cash, which may be the most expedient way to meet the determination of the prevailing wage, but "It's also the most expensive." He says working with companies that specialize in prevailing wage programs to invest those dollars in bona fide benefit plans is a much better fiscal decision.

McClanahan says the ease of setting up the plan was a pleasant surprise. "As a business owner, you don't want to make any mistakes," he says. "By using an outside service to do the plan design, the enrollment, the participant services and the compliance, I'm relieved of a huge burden. I know things are being done correctly."

McClanahan adds that the cost savings realized through a bona fide benefit plan are especially important in what he refers to as a "tight market." "Bidding on these government contracts is extremely competitive," he says. "Providing benefits reduces our payroll costs, improves our profitability and helps our employees all at the same time."

Unlike traditional 401(k) plans, the retirement plans provided by Fringe Benefit Group are tailored toward the needs of this market. If a contractor is doing a prevailing wage job, he or she contributes to the plan. Once the job is complete, if there are no other prevailing wage jobs at the time, the contractor can "switch off" the program. With traditional retirement programs, contributions are made regardless. The company also offers a flexible health care plan that features "hour banking." This is particularly helpful for contractors and their employees who do very seasonal work and run into issues with eligibility for benefits.

Joe Weber says one of the reasons he feels so comfortable working with the Fringe Benefit Group is that the company specializes in prevailing wage contractors. "They're not out there trying to sell property and casualty insurance or anything else. This is all they do. They really understand the market, they've been doing this for twenty-five years, and they're very service oriented."

While the regulations surrounding employee benefit programs and prevailing wage jobs can be complex, employers have many resources available to provide turn-key solutions that benefit both them and their employees. And while there may be some incidental costs to set up the program, these are quickly offset by the cost savings on payroll taxes, as well as the savings realized by increased employee retention. ■

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