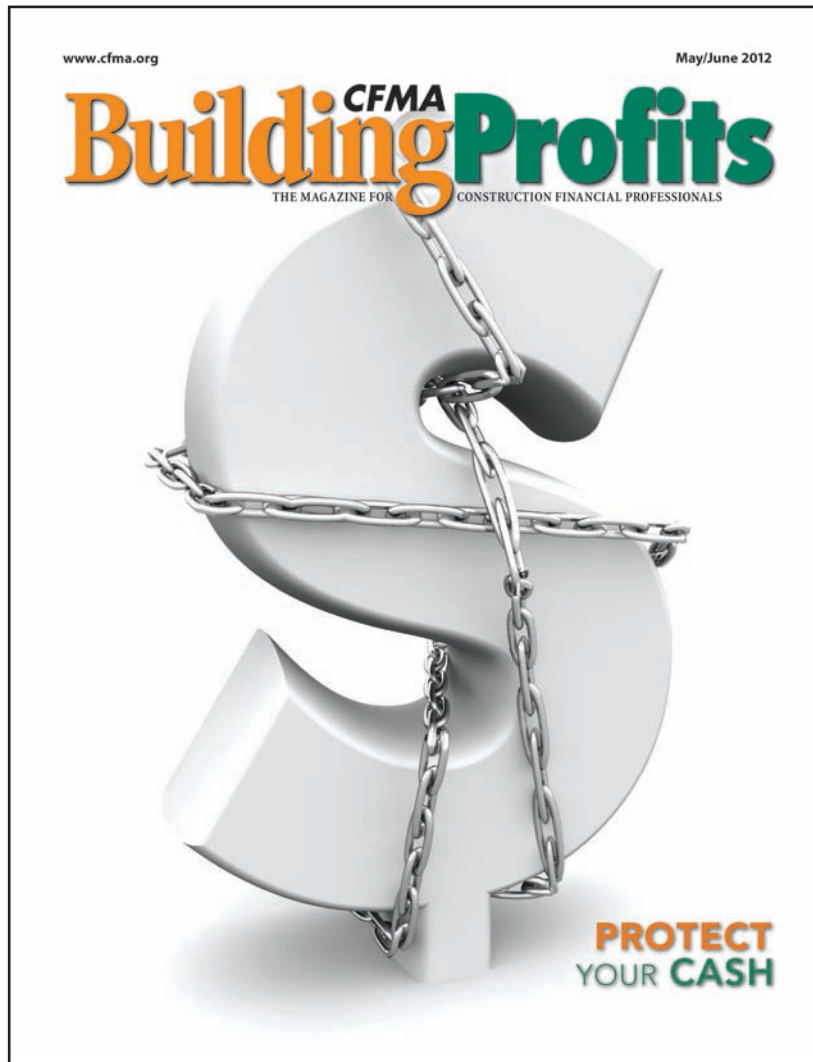


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The Source & Resource for Construction Financial Excellence

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PREVAILING WAGES: *Fringe Benefit Compliance*



There's no question that the past few years have been challenging for the construction industry.

When the *American Recovery and Reinvestment Act* (ARRA) was signed into law in 2009, many contractors that had not previously considered public works projects jumped into the arena, viewing it as a lifeline out of the lack of activity in the stalled private sector.

While the basic concepts of construction financial management apply to both public and private projects, working on those funded by taxpayer dollars adds a new layer of legal requirements to an already tightly regulated industry. Even professionals with years of experience in the laws that apply to publicly funded projects become frustrated by complex and, at times, seemingly contradictory regulations.

With several federal agencies increasing their focus on compliance, it's vital for anyone working on publicly funded projects to take advantage of every opportunity to learn how to prevent what should be a profit-generating project from decreasing the bottom line.

Such laws as the *Davis-Bacon Act*¹ that apply to federally funded construction can actually work to a contractor's advantage by reducing job costs and tax burden, and allowing some categories of employees to save more for their retirement while reducing overall costs for profit-sharing. Contractors, in turn, can become more competitive and win more jobs – even in a tough economic climate.

Before exploring how the *Davis-Bacon Act* can be used to save contractors money, it's important to understand the law's history and applicability.

WHAT IS THE DAVIS-BACON ACT?

Passed in 1931, the *Davis-Bacon Act* requires payment of locally prevailing wages, including the anticipated cost of prevailing benefits, on federally funded and most federally assisted projects.



Until passage of the ARRA, the *Davis-Bacon Act* applicability threshold for federally funded construction contracts was \$2,000. However, on May 29, 2009, the U.S. Department of Labor's (DOL) Deputy Administrator for Enforcement issued an all-agency memorandum that required all construction projects using ARRA funds be subject to the *Davis-Bacon Act* labor standards and wage determinations in accordance with Federal Acquisition Regulation (FAR) 48 CFR Subpart 22.4.²

Locally prevailing wages are generally expressed as a per-hour wage and per-hour cash equivalent value of benefits, and they are often based on a union scale. Prevailing wages are set by the DOL and are included in the bid specifications of covered contracts.

In addition to federal prevailing wage laws, 32 states and the District of Columbia have their own prevailing wage laws, often referred to as "little *Davis-Bacon Acts*." There are also a number of cities, municipalities, and counties that have their own prevailing wage laws.

These laws apply to construction contracts awarded by state, city, or other local agencies, and have a similar intention to the federal *Davis-Bacon Act*: To provide payment of locally prevailing wages and benefits to covered laborers or mechanics. The dollar threshold that triggers each state's prevailing wage law varies. Some states have no minimum threshold, while others are as high as \$500,000.

While federally funded projects subject to the *Davis-Bacon Act* include wage determinations for various classifications of workers, there is no law that mandates how the wages are paid.

Contractors usually pay the "base" portion as cash in the employee's paycheck and then offer the "fringe" portion as one of several options that might include:

- Vacations and holidays;
- Approved apprenticeship programs;
- "Bona fide" fringe benefits; or
- Cash treated as wages.³

The DOL requires that fringe benefit contributions be made to a "bona fide" benefit plan.⁴ Benefits that might be found in a bona fide benefit plan offering include retirement, medical, dental, vision, disability, life insurance, and supplementary unemployment plans. Since hourly workers who fail to save for retirement are left with few resources when they can no longer meet the physical demands of the job (or choose to stop working), these benefits provide important protections for these workers and their families.

Some contractors may mistakenly try to take credit for benefits they provide that are not recognized under the

Davis-Bacon Act. For example, contractors may incorrectly attempt to claim payment of workers' comp premiums where required by law, travel expenses, cell phones, or a truck allowance as bona fide benefits. While some states allow for these deductions, they are never allowed on *Davis-Bacon Act* projects.

Another area that can cause confusion is compensation for apprentices. It's economically appealing to hire apprentices to learn a trade because apprentice rates are only a percentage of the journeyman's base wage. However, the fringe rate is not adjusted for apprentices; it's the same fringe rate as full journeymen unless specified in the apprenticeship program's governing document. (Only the base wage rate is different for apprentices.)

In addition, the number of apprentices allowed on a job must be an acceptable ratio to journeymen. So, make sure there are an appropriate number of journeymen on a job where apprentices are working.

PREVAILING WAGE LAWS CAN BENEFIT CONTRACTORS & THEIR EMPLOYEES

Using the fringe portion of the prevailing wage to purchase benefits for hourly workers can result in significant payroll savings for contractors. Funds used to provide bona fide benefit plans on *Davis-Bacon Act* projects are exempt from FICA, FUTA, and state unemployment taxes, as well as from workers' comp insurance.

Since rates for state unemployment tax and workers' comp are not the same for all states, only a general estimate can be provided for the total savings. Most estimates reveal that payroll burden accounts for an additional 25 cents to each dollar paid to hourly workers as cash wages. Over the life of a contract, this can result in significant savings and therefore increase profitability.

Contractors that allocate the fringe portion of wages in this manner can reduce job costs, which allows them to submit more competitive bids, improves their chances of winning more contracts, and increases their project profit margins.

Dip into the Base

The federal DOL (and some states) permits contractors to "dip into the base,"⁵ which means contractors can allocate more than the specified fringe amount to a bona fide benefit plan as long as the base wage paid is more than the minimum wage. Therefore, contractors can pay the specified wages included on *Davis-Bacon Act* projects however they choose – as long as the total amount paid is at least equivalent to the wage determination.

For example, a worker's wage determination on a prevailing wage project might be \$30 in base wages and \$10 in fringes. The contractor could provide bona fide benefits using \$12 and pay the worker \$28 in cash wages. This results in more payroll burden savings for the contractor while remaining compliant.

Another opportunity to dip into the base exists in many areas where prevailing wages are substantially higher than a contractor's shop rates for some or all classifications. Since employees prefer to work on jobs that pay higher wages, this wage discrepancy can lead to such workforce problems as infighting over who works on prevailing wage jobs, reduced productivity, and even mistakes that must be corrected – again at the higher rate.

In order to reduce these workforce issues, contractors that dip into the base can level the cash wage with their shop rates and put the rest of the base wages and fringe benefits into a bona fide benefit plan.

Health Insurance Premiums

It's not unusual for contractors that perform prevailing wage work to pay all or some of the health insurance premiums for their workers, yet fail to take appropriate credit against the fringe portion of the prevailing wage for providing this benefit.

Often, employers that provide health insurance also pay out the fringe portion of the prevailing wage as additional cash wages. This is a costly mistake, since not taking credit for these premiums results in employers "double paying" for health insurance. By using fringe dollars to pay health insurance premiums, employers can realize immediate savings, which positively impacts their bottom lines.

Given the complexity of the laws that apply to public projects, contractors should work with their benefits provider to ensure that their plan complies with all regulations. Here are two common challenges employers may face.

Annualization

Annualization rules apply to health insurance on prevailing wage projects, which forces contractors to pay the same amount per hour toward these benefits for all hours worked. Alternatively, contractors can only reduce the fringe benefits by the amount deducted for private hours. Keep in mind that contractors cannot use the fringe benefits from public projects to subsidize the cost of the health insurance offered to employees when work is performed on private jobs.

Overtime

Another common mistake occurs when calculating overtime. Many contractors calculate their hourly fringe credit by dividing their monthly premium by the total average hours worked. When employees work more than that number of hours in a month, contractors must not continue to take the fringe credit for the extra hours.

Hour Banking

Some benefits plan providers offer a program called "hour banking," which simplifies tracking and credit use for health insurance and ancillary benefits.

In essence, workers earn a certain amount of money per hour toward benefits and can "bank" excess hours worked during peak times. Then, they can draw from those hours to continue coverage during slow times. When employees reach the maximum number of hours allowed in their bank, excess fringe dollars are redirected into the employee's retirement plan. This helps ensure compliance with DOL regulations.

Since the employer pays for actual hours worked, the possibility of overpaying for benefits is eliminated. And, employers know the exact cost per hour of providing these benefits, which can help with the submission of more accurate bids.

Hour banking is a consistent, transparent way to account for hours and contributions, is used in conjunction with a group major medical plan or program, and requires a special "active at work" definition.

Retirement Plans

Another area where contractors can benefit is by treating prevailing wage contributions to employee retirement plans as elective deferrals. Here are some options to consider when creating your company's retirement plan:

- *Basic Prevailing Wage Retirement Plan* – This type of plan only allows prevailing wage contributions. Employee elective deferrals are not allowed.
- *401k* – When prevailing wage contributions are treated as elective deferrals, company owners and key employees can contribute more.
- *Roth IRA* – When prevailing wage contributions are made, they are not tax deductible. The funds and accrued earnings can be withdrawn tax-free when the employee retires.
- *Profit Sharing* – For companies that do profit sharing,



prevailing wage contributions can be applied toward the amount of profit sharing, which significantly reduces costs.

- **New Comparability** – Companies can designate select classes of employees to receive higher contributions. This type of plan makes it possible for owners and highly compensated employees to maximize contributions to their own retirement accounts.

Contractors that currently use a Savings Incentive Match Plan for Employers (SIMPLE) should be aware that these plans are not appropriate for prevailing wage retirement plans. Prevailing wage contracts usually have many different job classifications and the wage determinations vary accordingly, which is prohibited with a SIMPLE plan.

Retirement plans are not subject to annualization requirements (except in a few states), which allows them to function as “catchalls” for the fringe benefits that remain after other deductions have been made.

Some prevailing wage benefit plan providers have systems in place to facilitate use of the whole fringe benefit portion of the prevailing wage for benefits and retirement. Generally, the fringe first pays the cost of health insurance premiums. Then, employees can choose from such other desirable benefits as vision, dental, and life insurance. Finally, any remaining fringe dollars can be automatically contributed to a prevailing wage retirement plan.

The benefits of using such systems are two-fold: Employees build their retirement savings and are protected from financial loss, and employers maximize their payroll and tax savings.

Another important factor to consider when working with a retirement plan provider is the loan provision. While some contractors allow loans on their traditional retirement plans, most will want to allow loans on their prevailing wage plans in order to reduce the number of employees who make early withdrawals subject to the 10% IRS penalty.

SUPPLEMENTARY UNEMPLOYMENT BENEFITS

A supplementary unemployment benefits plan, or SUB plan, is another allowable fringe benefit that can act as a catchall for unused fringe benefit dollars. SUB plans are essentially a vehicle to defer a portion of the fringe into a plan to be paid after an employee is laid off. These plans are only compatible with contractors that have a somewhat seasonal workforce that is laid off for a portion of each year.

SUB plans begin to pay out to employees shortly after they

are separated from unemployment, and do not interfere with an employee’s federal or state unemployment.

THE INS & OUTS OF COMPLIANCE

By now, it’s probably clear that projects funded with tax dollars come with some complex and unique regulations. Shortly after the ARRA was signed, President Obama publicly pledged that use of these dollars would come with accountability and transparency.

This pledge has been backed up with increased staffing for audits and compliance efforts. The DOL Wage and Hour Division (WHD) – the office responsible for the enforcement of the *Davis-Bacon Act* and other federal labor laws – has been steadily growing in size. In FY 2010, the WHD had 1,582 employees; the FY 2013 budget request, if approved, includes funds for 1,839 employees.⁶ This is a 16% increase in just three years.

Along with the increase in the number of employees, there is a corresponding increase in enforcement. In FY 2010, the WHD completed nearly 26,500 compliance actions.⁷ In FY 2013, the WHD hopes to complete 36,220 compliance actions,⁸ while not all of these are related to the *Davis-Bacon Act*, the increase is nevertheless sizeable. This increased focus on compliance is not confined to the *Davis-Bacon Act* or government contracting; the FY 2013 DOL budget request includes an emphasis on the *Fair Labor Standards Act* (FLSA) overtime, *Family and Medical Leave Act* (FMLA) enforcement, and misclassification of employees.

As a result, “sweep audits” are being conducted. This means an investigative team visits a contractor at random and unannounced, inspects records, and determines the contractor and its subcontractors’ compliance with the *Davis-Bacon Act* and other applicable laws. Subcontractors at all tiers have been a particular focus for investigators this past year.

GCs should understand that it’s ultimately their responsibility to ensure all of their subcontractors are aware of and compliant with the *Davis-Bacon Act*. The consequences for failing to comply with the *Davis-Bacon Act* can be severe, including payment withholding and debarment from work on federal projects for a period of three years, along with the possibility of being sued under the *False Claims Act* (FCA).

CONCLUSION

In an environment of increased focus on contractors and subcontractors for compliance with these laws, even those experienced with these regulations are searching for resources to

help avoid missteps. Contractors should carefully vet prospective benefit plan providers for experience with the unique requirements of prevailing wage benefit plans, and the expertise to help maximize the savings that can be realized when prevailing wage contributions are used correctly. ■

Endnotes:

1. www.dol.gov/compliance/laws/comp-dbra.htm.
2. Code of Federal Regulations (CFR) Title 48 – Federal Acquisition Regulations System, Chapter 1, Subpart 22.4: Labor Standards for Contracts Involving Construction.
3. www.dol.gov/whd/programs/dbra/faqs/fringes.htm.
4. For information on the DOL's definition of "bona fide" benefits, select Part 5 of the Code of Federal Regulations, Title 29, Chapter 1 – Labor Standards Provisions Applicable to Contracts Covering Federally Financed and Assisted Construction (Also Labor Standards Provisions Applicable to Nonconstruction Contracts Subject to Contract Work Hours and Safety Standard Act) found at www.dol.gov/dol/cfr/Title_29/Chapter_1.htm.
5. U.S. Department of Labor Field Operations Handbook 10/25/2010, Section 15f07(a), Discharging MW and FB obligations under DBRA.
6. www.dol.gov/dol/budget.
7. www.dol.gov/dol/budget/2012/bib.htm.
8. www.dol.gov/dol/budget/2013/bib.htm.

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