

REDUCING LABOR COSTS AND MAINTAINING DOL COMPLIANCE

SUCCESSFUL
TIPS FOR
CONTRACTORS
ON FEDERAL OR
STATE PREVAILING
WAGE PROJECTS

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For all contractors working on federal or state prevailing wage contracts, the goal continues to be keeping direct labor costs as low as possible, while complying with Department of Labor (DOL) regulations. Contractors working on public projects see unique challenges in that they must “comply” with a multitude of different agencies and regulations (i.e., DOL regulations, Internal Revenue codes, state annualization issues, classification of workers, etc.). Contractors must know the rules and regulations before the start of a project or possibly face future disbarment, personal liability and civil or criminal charges for not following the correct procedures. The following questions and answers can assist contractors in navigating some of the common problems of working in the public sector and can provide some insight on bidding more competitively on such projects.

Q What is a prevailing wage project?

A Generally, a prevailing wage project involves construction, reconstruction, maintenance or demolition on behalf of a public agency. All federal construction projects in excess of \$2,000 must comply with the rules and regulations outlined in the Davis-Bacon Act (www.dol.gov/esa/programs/dbra). In addition to the federal Davis-Bacon Act, more than 30 states have prevailing wage laws referred to as “little Davis-Bacon Acts.” Although many states follow the federal Davis-Bacon Act, state thresholds for coverage may be greater and the provisions and implementation of state regulations may differ.

Q What are the primary requirements a contractor must adhere to on a prevailing wage project?

A The Davis-Bacon and Related Acts (DBRA) require a contractor and all subcontractors to pay the prevailing wage: a predetermined wage and fringe benefit amount to all covered construction trades. Because these wage rates may typically be higher than the average private rate of pay, it is important to determine whether the related acts apply. Furthermore, the general contractor in most cases is ultimately responsible for prevailing wage compliance by its subcontractors.

Q How is it determined if a project is subject to the related acts and how does a contractor determine the correct wage and fringe benefit supplements?

A Typically, there will be a statement or clause in the contract/subcontract or the inclusion of a wage schedule. If none exists, then the contractor should ask the procuring agency or contracting officer if the project involves any federal or state funds. Davis-Bacon wage determinations must be used in accordance with the provisions of regulations, 29 CFR Part 1, Part 3 and Part 5. In most cases, the appropriate federal rates can be found on the federal DOL website, www.access.gpo.gov/davisbacon. Many states list these wage schedules on www.dol.gov/esa/contacts/state_of.htm. If both federal and state funds are involved,

generally the higher rates will prevail.

Some of the most common mistakes contractors make in the payment of prevailing wages include:

- Use of the wrong wage schedule (i.e. building, heavy, highway or residential).
- Misclassification of workers. Contractors must keep detailed records and supply certified payroll reports to the contracting agencies detailing the number of hours each employee works at each craft. Because the same worker may perform multiple duties, a contractor may want to require each employee to sign off weekly on the number of hours performed at each craft.
- Overtime payment. The Davis-Bacon Act does not require the contractor to calculate overtime on fringe benefit supplements, even if paid as cash wages (29

CFR 5.32). On a state-funded project, contractors should check with the state Department of Labor regarding overtime payments.

- Helper or apprentice classification. Currently there is no federal classification for a helper (states may vary). Apprentices must be enrolled, registered and attend a DOL-approved training program. Furthermore, ratios may apply as to the number of apprentices to journeyman.
- Travel time. Prevailing wages apply to “site of work” only. As such, contractors are not required to pay for travel time from an employee’s home to a covered project or for the delivery of materials to a covered site (29 CFR 5.2). If employees meet at the place of work then travel to the site, a contractor may be subject to the payment of prevailing wages.

Table 1. Your Company Savings

The following illustrates the savings if a company pays the entire fringe benefit rate into a bona-fide benefit plan.

Trade: Laborer		
Base Wage Rate:	\$16.00	
Fringe Benefit Rate:	\$8.00	
Total Hourly Prevailing Rate:	\$24.00	

	Fringe Benefits Paid as W-2 Income	Fringe Benefits into a Bona-Fide Benefit Plan
Total Hourly Prevailing Rate	\$24.00	\$24.00
Fringe Benefits: (Health, Pension, etc.)	- \$0.00	- \$8.00
Net Hourly W-2 Income:	\$24.00	\$16.00
Payroll Burden (Based on 25%) (FICA, FUTA, SUTA, Workers Compensation Premiums*, Public Liability Premiums)	x .25 \$6.00	x .25 \$4.00
Hourly Savings Per Employee	\$2.00	
	x 2000 hrs per year	
	\$4,000.00	
	x 10	
Annual Savings Per 10 Employees	\$40,000	

*where applicable

Table 2. Example of Hourly Credit for Benefits Provided

Trade		A Base Wage	B Fringe Rate	C Total	D Medical	E Holiday	F Vacation	G Pension	H Sub-Total Benefits	I Taxable Cash Wage
Roofer	A	\$25.00	\$12.25	\$37.25	\$ 1.31	\$ 0.46	\$ 0.38	\$ 10.09	\$ 12.25	\$25.00
	B	\$25.00	\$12.25	\$37.25	\$ 4.12	\$ 0.46	\$ 0.38	\$ 6.25	\$ 11.22	\$26.03
Sheetmetal	A	\$27.48	\$14.08	\$41.56	\$ 1.31	\$ 0.46	\$ 0.38	\$ 6.87	\$ 9.03	\$32.53
	B	\$27.48	\$14.08	\$41.56	\$ 4.12	\$ 0.46	\$ 0.38	\$ 6.87	\$ 11.84	\$29.72

• Rate changes during a contract. After a federal contract is awarded, the rate cannot change. However, many states may require updated rates throughout the course of the covered project.

Q How can a contractor meet prevailing wage obligations under the related acts?

A A contractor or subcontractor, at their discretion, can fulfill their obligations by paying any combination of wages and

benefits as long as it totals the amount listed on the wage determination. (Some states, such as New York, may require contractors to pay at least the wage rate as W-2 income, 29 CFR 5.31a/b.)

Q What is the most cost-effective way for a contractor to discharge its obligation?

A By providing qualified fringe benefits in lieu of cash wages a contractor can significantly lower its direct labor cost (see table

1). Generally, fringe benefits paid as a bona-fide fringe benefit, instead of paid to an employee as part of W-2 income, are not subject to payroll taxes and workers compensation (each state may have different regulations in regard to what is considered remuneration for purposes of workers compensation).

Q What is considered a bona-fide fringe benefit?

A • cash benefits—vacation, holiday, sick pay or supplemental unemployment;
• insured benefits—hospitalization, medical, dental, life or disability; and
• pension benefits.

Q What is not considered a bona-fide fringe benefit?

A • uniform/tool allowances;
• fringe benefit costs for non-prevailing wage employees;
• fringe benefit costs for non-prevailing wage work;
• use of company vehicles;
• employers' contributions to social security or any other statutory benefits;
• the company's administrative costs unless integrated into premium rates or pension costs; and
• mileage.

Q Can a contractor take "credit" for bona-fide fringe benefits it currently provides?

A Yes, in 29 CFR 5.27 it states, "the contribution for fringe benefits must be made pursuant to a fund, plan or program." An hourly equivalent cost for each bona-fide benefit paid by the employer then can be deducted from the specified fringe benefit amount. A contractor can calculate that hourly amount by dividing the annual costs of bona-fide benefits by the actual hours worked on both public and private work or 2,080 hours. (See table 2.)

Table 3. How Prevailing Wage Contributions Benefit the Owners and Top Staff

The same contributions that satisfy prevailing wage obligations can benefit you in another way. Prevailing wage contributions can be used to offset the amount of profit-sharing contribution a prevailing wage worker would otherwise receive under the profit-sharing plan, without an additional contribution from the company.

Profit-Sharing Offset

If an employer has been making fringe benefit contributions for prevailing wage workers at a rate of 10 percent of compensation and the employer then decides to make a similar profit-sharing contribution, the employer may only need to make a contribution for the non-prevailing wage workers. This can allow you to target profit-sharing contributions more effectively to the key employees and company owners.

Employees	Compensation	PW Contributions	PW as % of Pay	10% of Pay Profit Sharing Calculation	Profit Sharing Contribution Due	Profit Sharing Saved
Jones (PW)	\$ 30,000	\$6,000	20%	\$ 3,000	\$ 0.00	\$3,000
Smith (PW)	\$ 40,000	\$4,000	10%	\$ 4,000	\$ 0.00	\$4,000
Owner	\$100,000	\$ 0.00	0.0%	\$10,000	\$10,000	\$ 0.00
Accountant	\$ 60,000	\$ 0.00	0.0%	\$ 6,000	\$ 6,000	\$ 0.00
				\$23,000	\$16,000	\$7,000

This example shows the cross testing of a profit-sharing plan with a prevailing wage plan. This saved the employer \$7,000 in profit-sharing contributions, while allowing the owner to receive a 10 percent contribution.

(The profit-sharing document must have the appropriate language permitting the offset of the profit-sharing contributions against the prevailing wage contributions.)

Table 4. Using Prevailing Wage Contributions to Boost The Amount Company Owners and Top Staff Can Defer

When an employer makes prevailing wage contributions for its field workers, this money can be counted as if the employees actually chose to defer the money from their paycheck when determining the amount company owners and top staff can put into the plan. This is very important because otherwise company owners would likely either not be eligible to participate in the retirement plan owing to strict IRS participation rules, or would only be able to participate on a very limited basis. Conventional plans and administration often fail to utilize this simple yet very important fact.

401k **WITHOUT** Prevailing Wage Boost

(most traditional 401(k) plans do not have this boost provision)

NHCEs*	Pay	Deferrals	PW* Contributions	Average Deferral %	Test
Secretary	\$ 25,000	\$ 1,000	N/A	4.00%	4.00%
Bookkeeper	\$ 35,000	\$ 1,400	N/A	4.00%	4.00%
20 PW Employees	\$1,100,000	\$11,000	\$0	1.00%	20.00%
Totals (NHCEs)		\$13,400	\$0		28.00%
			Divide by # of NHCEs		÷ 22 employees
			NHCE Actual Deferral Percentage		1.28%
			Computed Maximum Allowed HCE Deferral Percentage (w/out Boost)		X 2 2.56%

*If a plan does not have a boost provision, any PW contributions do NOT factor into the Average Deferral Test (If the NHCE A.D.P. is below 2 percent, the HCE Deferral percent is 2 times the NHCE A.D.P.) (NHCE means Non-Highly Compensated Employees)

HCEs	Pay	Deferrals	PW Contributions	Actual Average Deferral %	Max Deferral % Allowed	Max Deferral Amount	HCE Taxable Excess*
Owner	\$170,000	\$12,000	N/A	7.06%	2.56%	\$4,352	(\$ 7,648)
Manager/Son	\$ 90,000	\$ 8,000	N/A	8.89%	2.56%	\$2,048	(\$ 5,696)
Total HCEs		\$20,000					(\$13,344)*

Note: The Maximum Salary Deferral Limit for 2004 is \$13,000 with a special catch up provision of \$3,000 for participants age 50 and older.

* Excess deferrals refunded to HCEs would be \$13,344

(HCE means Highly Compensated Employee—which usually translate into family members, owners and key staff.)

401k **With** Prevailing Wage Boost

(most traditional 401(k) plans do not have this boost provision)

NHCEs	Pay	Deferrals	PW* Contributions	Average Deferral %	Test
Secretary	\$ 25,000	\$ 1,000	N/A	4.00%	4.00%
Bookkeeper	\$ 35,000	\$ 1,400	N/A	4.00%	4.00%
20 PW Employees	\$1,100,000	\$11,000	\$100,000	11.00%	220.00%
Totals (NHCE's)		\$13,400	\$100,000		228.00%
			Divide by # of NHCEs		÷ 22 employees
			NHCE Actual Deferral Percentage		10.37%
			Computed Maximum HCE Deferral Percentage (with boost)		X 1.25 12.97%

(If the NHCE A.D.P. is below 2 percent, the HCE Deferral percent is 1.25 times the NHCE A.D.P.)

HCEs	Pay	Deferrals	PW Contributions	Actual Average Deferral %	Max Deferral % Allowed	Max Deferral Amount	HCE Taxable Excess*
Owner	\$170,000	\$12,000	N/A	7.06%	12.97%	\$13,000	0.00
Manager/Son	\$ 90,000	\$ 8,000	N/A	8.89%	12.97%	\$11,673	0.00
Total HCEs		\$20,000					0.00

Note: The Maximum Salary Deferral Limit for 2004 is \$13,000 with a special catch up provision of \$3,000 for participants age 50 and older.

The net result from placing prevailing wage (PW) contributions into a 401(k) plan with a prevailing wage provision is that it allows owners and key staff to obtain far greater benefits than are available inside a traditional (non-prevailing wage) 401(k) plan.

Q Which bona-fide benefits will provide the contractor with the most flexibility and cost effectiveness?

A A properly structured pension plan will allow a contractor to receive the maximum credit against the fringe benefit rate while avoiding all payroll-related expenses. Furthermore, under the Davis-Bacon Act and most state acts, a contractor can fund the plan solely on prevailing wage hours. For state-funded work, of the 30 states that have prevailing wage laws, approximately two-thirds have annualization requirements. For example, some states, such as New York, require contractors to annualize the cost of all bona-fide benefits, including pension. To receive full credit the plan must follow these guidelines:

- employees participate immediately;
- employees are 100 percent vested within 500 hours of service;
- contributions to employees do not exceed certain IRS limits; and
- the pension plan has a favorable letter of determination from the IRS.

Q How can a contractor utilize an exist-

For state-funded work, of the 30 states that have prevailing wage laws approximately two-thirds have annualization requirements.

ing profit-sharing plan to comply with the related acts?

A Because most profit-sharing plans are funded annually and on a discretionary basis, the plans usually will not comply with the related acts on a stand-alone basis. However, a contractor can establish a separate prevailing wage pension plan, covering only prevailing wage employees, and cross-test the two plans for coverage purposes (see table 3).

Q How can a contractor utilize an existing 401(k) plan to comply with the related acts?

A Because most 401(k) plans are funded with employee elective deferrals, the contractor will not avoid payroll costs and not receive maximum credit against the fringe benefit rate. However, the plan may be amended to include an additional contri-

bution source—prevailing wage. These contributions would cover only prevailing wage employees and include a separate service and vesting requirement from the 401(k) deferrals and match. Furthermore, these prevailing wage contributions can be characterized as QNEC (Qualified Non-Elective Contributions) or safe harbor contributions for testing purposes. (See table 4.)

For more information, visit the *Code of Federal Regulation (CFR)* website, www.gpoaccess.gov/cfr/.

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