

BuildingBusiness

A quarterly newsletter for construction,
real estate and hospitality industry professionals

Grant Thornton 

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Under the hard hat: Workers' compensation

Ben Franklin once said, "An ounce of prevention is worth a pound of cure." This statement is especially applicable in the area of workers' compensation, where prevention and forethought can have a significant impact on a business' bottom line.

Workers' compensation is insurance that is paid for by employers, providing cash benefits and medical care if an employee becomes disabled due to an injury or sickness related to the employee's job. Based on this general definition, one might assume that workers' compensation rates and regulations are generally stable across the United States.

As most businesses are aware, this is simply not the case. Regulations vary state by state, as do premiums.

According to 2002 data from the state of Oregon's Department of Consumer & Business Services, per \$100 of payroll, California and Florida rack up the highest workers' compensation premiums at \$5.23 and \$4.50, while North Dakota and Indiana have the lowest premiums at \$1.24 and \$1.37.

The good news is that the frequency of claims seems to be declining. The National Council on Compensation Insurance (NCCI) found that in 2002, claim frequency declined by more than 30 percent in every major industry.

Continued emphasis on workplace safety in all employment classes is among

the factors the NCCI says are driving the downward trend in workers' compensation claims.

A focus on safety

For workers' compensation in the construction industry, prevention is the name of the game. "When new employees and subcontractors begin work with a company, the importance of safety needs to be stressed up front," says Michelle Haskins, an attorney with Evans & Dixon LLC in Kansas City, Mo.

"Expectations should be clearly defined at the outset," she advises and suggests that noncompliance with these expectations and the company's safety procedures be presented as grounds for dismissal.

A comprehensive safety plan includes continued employee safety education, mitigating risks on each and every job site and identifying personnel within the organization — from all levels — to carry out the established expectations and policies.

"If anyone on a job site is injured, the foremen and supervisors need to be well trained and know what questions to ask, where the injured person should be sent for medical treatment and how to report the situation up through the appropriate channels," Haskins says.

When planning jobs outside of the home office's territory — well before work begins — construction companies should ensure that a nearby medical facility will accept >



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Michelle Haskins is an attorney with Evans & Dixon LLC in Kansas City, Mo.

its workers' compensation insurance.

Haskins advises that, generally, occupational medicine clinics are better suited to address on-the-job injuries, and are familiar with medical-legal issues, including drug testing following the accident, issues of causation, and forms necessary for return to work. "This isn't always true of a general medical practitioner or family medicine clinics," she says.

Potential work hazards

Workers' compensation does not begin and end with material- and equipment-related injuries. Horseplay, practical jokes and drug and alcohol use can also give rise to injuries.

Haskins notes that while a congenial workplace is something every employer strives for, if the employer is aware of horseplay on the job site and doesn't take steps to stop it, it could turn into a workers' compensation situation.

Drug and alcohol use on the job site can also be an issue. "If a person is impaired in some way, he or

she must be taken off the job site immediately," points out Haskins who warns that employers can still be found responsible if a worker is not fully lucid and is injured on site.

Injuries resulting from personal arguments on the job site can also lead to workers' compensation, if they can be connected with the workplace. "If the argument is over one employee getting better pay or hours than another, workers' compensation is more likely to apply, as opposed to the situation where the argument is purely personal in nature," says Haskins.

However, applying some forethought and planning can prevent on-site arguments. "If you know two workers don't get along, don't put them on the same job site or in the same vicinity of the building," she advises.

"Regardless of the situation, if you are aware of a potentially dangerous situation and someone gets hurt, there's a strong possibility that it is the company's responsibility to pay." ■

All aboard! CFMA rolls out certification program

Financial professionals in and serving the construction industry will soon have a new standard to measure their expertise by. The Construction Financial Management Association (CFMA) is holding its first Certified Construction Financial Professional (CCFP) exam at the CFMA annual conference in New Orleans on May 22.

"This exam will be a watershed for CFMA," says Dick Rice, head of the CFMA Certification Committee, who likens the inaugural certification exam to the beginnings of CFMA itself.

"Just as in 1981 when a group of financial professionals in the construction industry realized the need for and organized what is now CFMA, this exam is reflective of the current wants and needs of the industry."

This, however, was not always the case. In the mid-90s CFMA's membership was polled on the needs for certification, and, at that time, the idea was rejected.

But, the times have changed.

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In 2001, another financial professional at a conference queried Rice as to why CFMA did not yet offer a certification program. "She insinuated that if we did not offer certification, we would miss the train that most other construction associations were already riding on," he says.

After polling the membership once again, CFMA found that 84 percent of the membership felt that the association should sponsor a certification program, and the train gained steam.

Committees were formed; the Institute of Certified Construction Financial Professionals was established to govern the certification process; potential exam questions were provided by CFMA membership and reviewed by Knapp & Associates, specialists in credential program development; and an exam date was set.

"We've received a very good response both from those participating in the exam, and those supporting the exam fundamentally and financially," says Rice.



Dick Rice is head of the CFMA certification committee

And, this response has not been limited to financial professionals at construction companies. The exam is geared toward, and has gained support from, a broad range of financial management construction professionals, including accountants, surety bond agents, bond underwriters, insurance brokers, attorneys and software providers.

"The certification perfectly dovetails with CFMA's mission to provide education to financial professionals in the construction industry," says Todd Taggart, a tax partner with Grant Thornton's Minneapolis office, who serves on the CCFP committee and co-chairs CFMA's Vision/Marketing Committee. "And, it positions CFMA as the source of construction financial education."

(Continued on page 4) >

Shared appreciation mortgages: What you should know

By Jerry Williford, Charlotte, N.C., tax executive director, and Todd Sinnett, Charlotte tax manager

Lenders often use shared appreciation mortgages (SAMs) when making loans on properties that are perceived to be risky investments or when interest rates are high.

In the typical SAM arrangement, the lender provides a developer with a loan bearing a fixed rate of interest, plus a share of the profit on a subsequent disposition of the property.

For example, assume that the developer, an individual, plans to build a shopping center in a depressed part of a city in hopes that that the area will turn around. The developer is having trouble finding a permanent loan at the going rate of 6 percent. However, the developer is able to locate a lender that will loan the necessary funds at 5 percent, but wants 25 percent of the gain on a subsequent disposition of the building.

The developer borrows \$40 million from the lender and completes the center at a cost of \$40 million. The center cash flows, interest and principal are paid monthly to the lender.

The center is successful and, at the end of year five, the developer sells the center for \$80 million. Under the terms of the loan, the lender is paid the balance of the loan plus 25 percent of the gain over the original cost of \$40 million, or \$10 million.

A taxing issue

This type of loan raises an important income tax issue: How should the borrower treat the payment of the share of appreciation to the lender? Is the payment deductible interest expense? Or, does the sharing of the profits from the sale of the property create a partnership for tax purposes between the borrower and the lender?

If it is interest expense, then the borrower would most likely have an ordinary tax deduction. On the other

hand, if the lender is deemed to be a partner with the borrower, then the lender will have less capital gain on sale and the tax effect can be significant.

Using the above example, assume that the developer's tax basis in the center at the time of sale is \$30 million so that the developer has a tax gain on sale of \$50 million (\$80 million less \$30 million). Can the developer take an interest deduction for \$10 million so that the developer has a \$50 million capital gain and an ordinary deduction of \$10 million?

Or, is the lender deemed to be a partner with the developer so that the developer's capital gain is \$40 million (\$50 million total gain less \$10 million to lender), but with no ordinary deduction?

Since capital gains rates for individuals are much lower than ordinary rates, the developer will most likely want the interest deduction.

In a 1983 ruling, the Internal Revenue Service (IRS) concluded that the payment of the shared appreciation was interest, except in the case of commercial transactions.

On the commercial side, the IRS has provided no guidance. In fact, in 1999, the IRS' National Office addressed a SAM situation for a particular taxpayer raised by an examining agent without coming to any conclusion.

The courts have also not been active in this area. In fact, there appears to be only one case that has addressed a somewhat similar arrangement to a SAM, but the facts of this case make it difficult to apply to the typical SAM arrangement. In this 1960 case, the Second Circuit found that the payment was for an equity interest, thus not deductible as interest. The payment to the lender, however, was in settlement of litigation that resulted making this case of questionable authority.

Should not create a partnership

It seems clear from other IRS rules and court cases that in SAM arrangements the borrower and lender are not partners for tax purposes.

In determining whether a partnership exists for tax purposes, the courts look at a number of factors, including intent, joint division of profits, sharing of losses, capital investment, participation in management, and holding out to public. Of these, intent seems to be the most important factor. Clearly, the borrower and the lender do not intend to be partners. Also, except for the loan, the lender has not provided capital and the lender does not share in management.

Payment should be interest expense

It also seems clear that the payment is interest.

There is no definition of interest in the code or regulations. However, courts have generally defined interest as the amount that one has contracted to pay for the use, forbearance or detention of money.

There is no requirement that the interest be reasonable and even if the interest is usurious, i.e., illegal in a state, it is deductible. In addition, it is not necessary that a lender charge a percentage of the sum loaned.

Therefore, it seems clear that the payment of a share of the appreciation to a lender in connection with a loan should result in an interest deduction.

Taxpayers should also be aware that the IRS could raise the issue and argue that the lender is a partner with the borrower with the payment of the share of appreciation not being deductible as interest. ■

For more information on SAMs, contact Jerry Williford at 704.632.6903, Jerry.Williford@gt.com; or Todd Sinnett at 704.632.6838, Todd.Sinnett@gt.com.

All aboard! CFMA rolls out certification program *(continued from page 2)*

Exam requirements

1. Formal education

A bachelor's degree from an accredited college or university, including at least 12 credit hours in business-related coursework.

- or -

Four years of experience working for a construction company in its accounting and/or finance department, or as a provider of accounting and/or financial services to the construction industry.

2. Professional experience

Four thousand hours of experience in construction-related activities within the last three to five years. This experience must be in a professional financial position for a construction contractor or as a provider of accounting and/or financial services to the construction industry.

3. Verification of work experience

Participants must provide a list of relevant financial work experience in the construction industry.

4. Agreement to adhere to the Certified Construction Financial Professionals Code of Ethics

All candidates must assert that they have conducted themselves in an ethical manner in the past and must pledge to continue to do so in the future. As such, candidates must agree to adhere to the Code of Ethics.



In conclusion, Rice says he is proud of his involvement in this historical event. "I am thrilled to be taking part in the formation of the CCFP," he says, "which will be viewed by others in the field as an attestation to the skills in and understanding of financial issues in the construction industry." ■

For more information or to sign up for the CCFP, visit www.cfma.org.

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