



BUILDING BLOCKS

JANUARY 2013

President's Message

The year ended with a lot of concern over the fiscal cliff, and I'm sure it triggered many to sell investments in the hopes of saving on capital gains taxes, as well as gifting property to take advantage of the \$5 million exemption on estate taxes. Surprisingly, the market didn't experience a crash and, in fact, ended on an up-swing, which has continued through the time that I'm writing this article. Similarly, it turns out that the \$5 million estate tax exemption has continued and appears to be permanent. Well, I guess this is one instance where the procrastinators may have actually benefitted, or at least were not penalized, for putting off their actions. [In this edition of Building Blocks, CW Associates has graciously contributed an article on the new tax changes, so read on to get you up to speed on taxes.]

I have never been any good at investing in the market. All of my individual stock investments have lost money, so I gave up trying. The only thing that has done reasonably well has been my 401(k) plan. Eleven years ago, I rolled over funds from my previous employer when I started working at Ralph S. Inouye Co., Ltd. Granted it was after the tech bubble burst in 2001, I just checked my account online and discovered that my annual rate of return has been 7% since 2002. Not too shabby. Now that I am "up" again, I'm debating whether or not to get out of the market and wait for clearer signs of a rebound or perhaps another large correction. Since these are tax-deferred funds, I don't have to worry about generating any gains, and there are many contingencies out there in the US and global economies which make a continued bull run seem hard to believe. By the time this article goes to print, things might be different already, but for now I'm still on the fence as I watch the DJIA slowly inch its way upward.

On the local level, I read articles about how construction is picking up, and how busy we will be by the end of this year. One of our drywall subcontractors said that his union representative foresees an empty bench by the close of 2013. Despite the talk of a number of large-scale projects moving ahead (condos, hotels, mil-

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President's Message

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itary, rail transit), I honestly don't see a lot of activity for the small-to-medium sized projects where we have historically competed. As we burn through the backlog that we generated in 2011-2012, I look forward with the hope that the media predictions come true. The longer I stay in the industry, the more I can relate to the 'feast or famine' cycles that people talk about. There never seems to be just the right amount of work out there. Of course, given the choice I'd rather be busier, so it's time again to reel in the engineers and have them sharpen their pencils to try to pick up more jobs.

In closing I just want to share this picture I saw on the internet, which made me laugh. I tried to think of a clever way to incorporate it into my message, but sorry, couldn't find one. I've always had a fascination with sharks and loved drawing them as a kid, even though the thought of them kept me in the shallow waters, so this is especially funny to me and I had to share it. Have a wonderful 2013, and see you at the upcoming events!

- Wes



AGC/CFMA Construction Financial Management Conference

October 24-26, 2012

Prepared by Ray Nii, Grace Pacific Corporation

Eight members from our Honolulu Chapter attended the 16th Annual AGC/CFMA Construction Financial Management Conference in Las Vegas. This two and a half day conference was jam packed with a variety of educational sessions geared toward the financial professional (accounting standards update, financial reporting update, construction tax update, risk management, IT and cloud computing, cost controls, succession planning, and a whole lot more).

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AGC/CFMA Construction Financial Management Conference

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At this year's conference, there seemed to be a little more optimism when looking toward 2013. There should be some Federal government spending on construction (no matter which candidate is elected President). However, there still is the uncertainty of what may happen if the "fiscal cliff" issue is not resolved. The Surety Industry looks to take a big hit this coming year. This hit is something that was anticipated since they have not had a big "give back" year in awhile despite the recession. It is still interesting that we have not seen a lot of big failures in the past year . . . perhaps this coming year?

Current and future trends/requirements to watch for in the construction industry are:

- Companies will be subject to tighter surety controls
- The reporting requirements on the multi-employee disclosure form and issues surrounding union pension liabilities
- Revenue recognition – updated standard expected out in 2013 with effective date to be determined (not earlier than Jan 2015); the new standards will require retrospective application, meaning that we will soon need to start capturing transactions under both the new and existing standards so that comparative financial statements can be presented appropriately.
- Cloud computing is here to stay and it is just a matter of time before all software and server functions will be hosted in remote data centers. The primary driver is financially it makes sense. The

services will essentially be scaled to what you need and the reliability and access to your information will far outweigh an in-house server setup.

- Unpredictable tax policies pending the outcome of the Presidential elections. There are several tax changes that are set to go into effect in 1/1/13, including the expiration of the employee FICA tax holiday and additional Medicare and Health insurance taxes.
- Shortage of qualified personnel in construction - the recession has caused many construction workers to seek employment in other fields. As the construction industry slowly starts to recover along with the economy, there will be an ongoing challenge for firms to hire qualified personnel to work on their projects.

Besides the educational opportunities that the conference provided to us, we were able to network with other financial professionals from around the country. Making connections – you never know how the connections made at a conference (or at any other CFMA sponsored activity, be it national or local), may be of mutual benefit sometime in the future.

The AGC/CFMA Construction Financial Management Conference did provide all of us with good educational opportunities, good connections, and good times. We urge you all to think about attending a national CFMA conference in the future – it will be worth your investment..

Holomua Site Tour

CMFA members toured the Holomua condominium building on October 25, 2012. The Holomua project is a guaranteed maximum price contract consisting of the construction of a new twenty-three story concrete structure built as an “affordable housing” condominium facility. Levels #1 through #7 are a parking structure with 211 parking stalls. Levels #8 through #23 is the residential tower consisting of 176 residential condominium units. The building area is approximately 234,700 sf. The project includes an emergency generator, three passenger elevators and the associated on-site and off-site development. The project duration is 17.5 months. The project site is located at 1315 Kalakaua



Avenue in Honolulu (east of Downtown Honolulu near the entrance to Waikiki). The Owner/Developer is KRC Partners, LLC and the Archi-

tect is Kazu Yato, AIA & Associates, Inc.

CFMA would like to thank Kenneth Spence from Nordic PCL Construction for facilitating this tour.

Brown Bag: Surety Market Update & the 2013 Changes to the EMR Calculations

CFMA associate member Stephanie McGuire, along with John Bustard from King & Neel, were the feature presenters at our November 27th Brown Bag luncheon. Sixteen members and two guests sat in on this presentation and were treated to lunch from Best Drive Inn.

Stephanie McGuire spoke about the upcoming revisions to the Experience Modification Ratings that will go into

effect on January 1, 2013. There will be incremental increases to the maximum primary loss component from 2013 to 2015, and will be adjusted annually thereafter. Depending on your company's safety record, incident rates, and severity of the accident/claims, the forthcoming increases to the primary loss component could have a dramatic effect on your company's Experience Modification Ratio ("EMR"). Stephanie gave an example of how the incremental

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Brown Bag: Surety Market Update....

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increase of the maximum primary loss component from \$5,000 to \$10,000 could increase your EMR by 8%. Remember that insurance carrier's use your EMR as a factor in determining your company's Workers Compensation insurance premiums. Further, for those contractors who do work with the Federal government, the Feds use EMR as one of the criteria in their bidding process. These changes to the way EMR is calculated could very well cost your company more monies in premiums as well as affect your company's ability to bid on certain jobs.

John Bustard gave us an update on the Surety markets. John's main message – Due to current economic conditions, the state of the construction industry nationwide, and an increase this year in surety losses, many sureties will scrutinize companies more than what they have done in the past before agreeing to write bonds for a project (looking closer at the financial statements, outstanding legal issues, debt to equity ratio, etc.). John mentioned that subcontractors may have a more difficult time obtaining bonds as most of the contractual items with the owner are out of their control, but if subcontractors mitigate their risk



regarding payment terms, scheduling and other contractual issues, bonding companies will look at them more favorably. In regards to protecting your company's ability to obtain bonds for new work, John suggested to make sure your relationships with your bonding agent and bonding company are solid, and if not, take steps to improve them. He also mentioned that it is important to look further into the following areas:

- (a) Protect your lien rights
- (b) Pay on time
- (c) Read the fine print in the contract documents and bond forms
- (d) Get it in writing – if it is not in writing, it probably will not hold up in court
- (e) Know the “health” of the subcontractors that you use on your jobs.

CFMA would like to thank Stephanie and John from King & Neel for presenting at this Brown Bag event and providing all of us with this update.



CFMA 2013 Kick-Off Party

After a busy Holiday Season, CFMA members and their guests got together for an evening of fun, catching up and learning...learning the finer points of preparing pasta and sautéing seafood that is. On January 17, 2013, fifty CFMA members and their guests gathered at A Place to Eat restaurant located in Puck's Alley. Chef Willu Diaz graciously offered to host CFMA's 2013 kickoff party and make it a memorable learning experience. The party started off with beer and a selection of wines by our CFMA sommelier Neill Char to go along with 3 of Willu's dishes, MacNut Mahi Mahi, Wok Fried Soba, and a special dish not on the menu, Li Hing Kal Bi. Li Hing Kal Bi?? Why hasn't anyone thought of that before? Great

food, drinks, conversation...oh and then throw in the live music of Alex Kawakami from Manoa DNA. But that was just the beginning as Willu performed cooking lessons throughout the night on 2 of his signature dishes, Adobo Sea Scallops and Basil Orange Scampi. It's doubtful that anyone would be able to replicate Willu's dishes, but he did leave us with a few helpful tips. 1) Add olive oil to your boiling pot of pasta, and be generous. Not only does it add taste, but it'll prevent your pasta from sticking. 2) Adding a chunk of butter to your sautéed dish does wonders...not at the beginning, but at the end.

The CFMA Board could not have asked for a better turnout and event. We are excited for the upcoming year and hope everyone continues to come out to get connected and maybe learn a thing or two.



CFMA 2013 Kick-Off Party



New Year
Party

2013 TAX CHANGES AFFECTING BUSINESSES AND INDIVIDUALS

Prepared by the Tax Department at CW Associates, CPAs

There are significant tax law changes affecting all taxpayers in 2013. The enactment of the 2012 American Taxpayer Relief Act (“ATRA”) avoided the “fiscal cliff” by extending, either permanently or temporarily, a number of tax incentives that were set to expire at the end of 2012. However, not all provisions are favorable for taxpayers. In addition, the new Medicare and Hospital Insurance surcharges became effective January 1, 2013, and there are other changes due to inflation indexing and recent IRS guidance. The following is a summary of the significant tax law changes affecting businesses and individuals.

CHANGES AFFECTING BUSINESSES

Bonus depreciation – The 50 percent bonus depreciation is extended through 2013 (through 2014 for certain longer-lived and transportation property). A taxpayer eligible for additional first-year depreciation may elect to claim additional research or minimum tax credits in lieu of claiming depreciation for qualified property. In addition, a conforming change was made relating to bonus depreciation as a cost in applying the percentage of completion method for certain long-term contracts (consistent with the current treatment for Section 179 expensing).

Section 179 expensing – The dollar and investment limits for 2012 and 2013 remain at their 2011 amounts (\$500,000 and \$2 million) and adjusts those amounts for inflation. The new law also provides that through 2013, off-the-shelf computer software, qualified leasehold improvement property, qualified restaurant property, and qualified retail improvement property is eligible for Sec. 179 expensing.

Other depreciation provisions:

- The \$8,000 increase in first year depreciation for a passenger automobile that is qualified property, light trucks, or vans is extended through 2013.
- The treatment of qualified leasehold improvement property and qualified restaurant property as 15-year property is extended through 2013.

S corporation built-in gains tax – For determining the recognized built-in gain for tax years beginning in 2012 or 2013, the recognition period is the 5-year period beginning with the first day of the first tax year for which the corporation was an S corporation.

Other tax credits and incentives – The following tax credits and incentives have been extended through 2013:

- Research tax credit
- Work Opportunity Tax Credit
- Employer wage credit for activated military reservists
- Credits for manufacturers of energy efficient new homes and appliances

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2013 TAX CHANGES AFFECTING BUSINESSES AND INDIVIDUALS

Prepared by the Tax Department at CW Associates, CPAs

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Tangible property regulations – The IRS has delayed the effective date of the temporary regulations relating to tangible property until 2014, and plans to issue final regulations in 2013, also with a 2014 effective date. So, companies have the option of following the temporary regulations in 2012 and 2013, or waiting until 2014 to adopt the new rules.

CHANGES AFFECTING INDIVIDUALS

3.8% Medicare tax on investment income – Starting in 2013, a 3.8% Medicare surtax will be imposed on the net investment income of high income individuals. This “surtax” is in addition to any other tax payable and is 3.8% of the lesser of (1) net investment income or (2) the excess of modified adjusted gross income (“MAGI”) over the threshold amount (\$250,000 for joint filers or surviving spouses, \$125,000 for a married individual filing a separate return, and \$200,000 in any other case). The threshold amount is not indexed for inflation. MAGI is adjusted gross income (“AGI”) plus any amount excluded as foreign earned income. For 3.8% surtax purposes, net investment income is investment income less deductions properly allocable to such income. Investment income generally includes:

- Gross income from interest, dividends, annuities, royalties, and rents, unless derived in the ordinary course of a trade or business to which the 3.8% surtax doesn't apply,
- Other gross income derived from a trade or business to which the Medicare contribution tax does apply (e.g. passive income passed through from partnerships and S corporations), and
- Net gain (to the extent taken into account in computing taxable income) attributable to the disposition of property other than property held in a trade or business to which the Medicare contribution tax doesn't apply.

Additional 0.9% Medicare tax on earned income – Starting in 2013, an additional 0.9% Hospital Insurance (“HI”) tax is imposed on higher income earners. The additional tax applies to an individual’s total wages, other compensation, and self-employment income (included self-employment income passed through from partnerships and S corporations) for the tax year that exceed specified thresholds, without limit. These thresholds are \$200,000 for a single individual; \$250,000 for married couples filing a joint return; and \$125,000 for married filing separately. For married couples, the tax applies to the combined earned income of both the husband and wife, unlike the general 1.45 percent HI tax that applies to wages and other earned income of individuals. Employers will be required to withhold an additional .9 percent if an employee receives wages that exceed \$200,000. The penalty for underpayment of estimated tax applies to the 0.9 percent tax. Thus, even though an employer does not have to withhold on an employee whose income is \$200,000 or less, the employee may be responsible for estimated tax if the employee’s income – whether wage income, self-employment income, or both -- combines with the spouse’s income to exceed the applicable \$250,000 threshold on married couples.

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2013 TAX CHANGES AFFECTING BUSINESSES AND INDIVIDUALS

Prepared by the Tax Department at CW Associates, CPAs

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Tax rates – ATRA preserves and permanently extends the Bush-era income tax bracket structure of 10, 15, 25, 28, 33, and 35 percent, except for single individuals with taxable income above \$400,000; married couples filing joint returns with taxable income above \$450,000; and heads of household with taxable income above \$425,000. Income above these thresholds will be taxed at a 39.6 percent rate, effective January 1, 2013. The \$400,000/\$450,000/\$425,000 thresholds will be adjusted for inflation after 2013.

Payroll tax holiday – The payroll tax holiday was not extended. Effective January 1, 2013, the employee-share of Social Security increased from 4.2 percent to 6.2 percent (its rate before enactment of the payroll tax holiday). The net result is that all individuals who receive wages (and self-employed individuals) will see less take-home pay in 2013.

Capital gains and dividends – Effective January 1, 2013, the maximum tax rate on capital gains and qualified dividends rises from 15 to 20 percent for taxpayers whose incomes exceed the thresholds set for the 39.6 percent rate (the \$400,000/\$450,000/\$425,000 thresholds discussed above). The maximum tax rate for all other taxpayers remains at 15 percent, and a zero-percent rate will continue to apply to qualified capital gains and dividends to the extent income falls below the 15-percent tax bracket.

Alternative Minimum Tax – The alternative minimum tax (“AMT”) was put in place more than 40 years ago to ensure that very wealthy individuals did not escape taxation. Due to many factors, including the fact that the AMT was not indexed for inflation, the AMT has encroached on middle-income taxpayers. In recent years, Congress routinely “patched” the AMT by increasing the exemption amounts. ATRA permanently patches the AMT by increasing the exemption amounts for 2013 and indexing them for inflation.

Tax credits and deductions – Some popular tax credits and deductions for individuals made permanent or extended by the new law include:

- Child tax credit (permanent)
- Enhanced adoption credit/exclusion (permanent)
- Enhanced child and dependent care credit (permanent)
- Enhanced student loan interest deduction (permanent)
- American Opportunity Tax Credit (through 2017)
- Higher education tuition deduction (through 2013)
- IRA distributions to charitable organizations (through 2013)
- Transit benefits parity (through 2013)
- Cancellation of indebtedness on principal residence (through 2013)
- Residential energy efficient property credit (through 2013)

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2013 TAX CHANGES AFFECTING BUSINESSES AND INDIVIDUALS

Prepared by the Tax Department at CW Associates, CPAs

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- Teachers' classroom expense deduction (through 2013)
- Deduction for state and local sales and use tax instead of state and local income taxes (through 2013)
- Standard deduction marriage penalty relief (permanent)

Itemized deductions and personal exemptions phase-out – Itemized deductions will be reduced and the personal exemption will be phased out for individuals with incomes over \$250,000 and married couples with incomes over \$300,000. These dollar amounts will be adjusted for inflation after 2013.

Estate tax - Effective January 1, 2013, the maximum estate, gift and GST tax rate is 39.6 percent, which reflects an increase from 35 percent for 2012. The exclusion amount for estate and gift taxes is unchanged for 2013 and subsequent years at \$5 million (adjusted for inflation). The GST exemption amount for 2013 and beyond is also \$5 million (adjusted for inflation). The new law also makes permanent portability, which allows the surviving spouse to utilize the unused exclusion amount of the deceased spouse.

Gift tax – The annual gift tax exclusion is increased from \$13,000 to \$14,000.

Retirement planning – The following is a summary of changes affecting retirement planning:

- Deferral amount for 401(k) and 403(b) plans is increased from \$17,000 to \$17,500.
- Taxpayers will be allowed to transfer funds from a qualified retirement plan to a Roth IRA at any time, if the retirement plan includes a qualified Roth contribution program.

CW Associates, CPAs, consists of 30 professional accountants, including four partners. The firm serves businesses in the construction industry, and their owners.

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