

Providing Fringe Benefits in the Prevailing Wage World

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Though prevailing wage employers are, in many respects, no different than other employers, hopefully they take advantage of the tax benefits found when providing fringe benefits to their employees. A decade ago, many employers adopted benefit plans, in lieu of paying cash, simply for the tax benefits. While the benefits of the tax savings to the business remain valid, in today's tight labor market, employers are also adopting benefit plans as a worthwhile tool to attract and retain valuable employees.

A Little History on Prevailing Wage Contracts

The Davis-Bacon Act, which took effect back in 1931, requires contractors working on federally-funded projects to pay 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 \$30 per hour cash wage and \$8 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 \$38) 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 because it doesn't allow employers to realize the cost savings of providing their employees a bona fide benefit plan. The cash option is so much more expensive because 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.

Numerous studies have documented the critical importance of private pension savings and its role in the economic security of retirees. Our nation's Social Security system is facing significant funding issues and potentially reduced benefits for future retirees. Independent of Social Security, too many workers have saved too little, if anything at all. The lack of personal savings combined with the looming Social Security problem poses significant future economic problems for the average construction worker. It's for this reason more and more employers are adopting retirement plans.

However, employers working on publicly financed construction projects must balance the often inconsistent requirements of the respective prevailing wage statute that applies with the requirements of the Internal Revenue Code, the Employee Retirement Income Security Act (ERISA) and state insurance laws. While these additional requirements may not be inconsistent with the fringe benefit requirements in a prevailing wage policy, they may not be consistent or even easily reconcilable. Probably one of the most common mistakes that occurs when analyzing fringe benefit programs is when a firm fails to appreciate these inconsistencies and takes a “one-size-fits-all” approach with their benefit program. Contractors tend to have fewer problems when they rely on fringe benefit companies that are knowledgeable of this market.

Understanding the many distinctions is critical. While there are many prevailing wage laws in existence today—the federal Davis-Bacon Act requirements as well as thirty-two different state laws—let’s focus on federal requirements and touch on unique aspects of a few state laws. No two of the thirty-two state prevailing wage laws or the federal Davis-Bacon Act are exactly the same. While the intents are the same, the wording, terms, implementation and enforcement all vary significantly. Do not assume because you understand one policy you understand them all.

Common Pitfalls When Calculating Prevailing Wage Benefits

One of the most unique aspects of the Davis-Bacon Act and state prevailing wage laws is the “annualization” requirement—an employer must make the same fringe benefit contribution on all hours worked, including time spent on both public and private projects. The Davis-Bacon Act requires annualization, but there is an exemption for defined contribution pension plans with essentially immediate vesting. Prior to the end of ERISA pre-emption of state prevailing wage laws, most states either weren’t this specific or didn’t focus closely on this area. The shifting state policies in this area tend to create confusion and discourage employers from adopting retirement plans. This shouldn’t be the case, however, because the upsides (tax savings for the employer and a retirement savings plan for the employee) far outweigh the downsides.

“We do all prevailing wage work, and in the past, we paid the fringe in cash. The tax benefits we are now experiencing enables us to be more competitive,” says Jim Shannon, president of SK Mechanical in Ephrata, PA, a business focused entirely on designing and installing fire protection systems. “I run a small company and I don’t have time to keep up with changes in the law. Using a third-party with an approved program means that I don’t have to worry about gray areas—they’ve got me covered, and I know that all of our records are being validated and checked by a third party.”

Shannon also says that employing an experienced, outside fringe benefit provider saves him time. “I’ve got a lot of young employees, and if any of them have questions, I just direct them to call our plan administrator. For me, it’s peace of mind because I know I’ve got professionals looking out for me and my business so I can focus on what I do best—which is fire protection systems.”

“When we first implemented the plan, we heard some complaints, but now that our employees can go online and see the balance on their retirement plans growing, they are happy. For those that have been with us for the two years we’ve offered the plan, they say, ‘Wow, that’s a lot of money in my account,’” continued Shannon.

Another confusing area for business owners is overtime. Under the Davis-Bacon Act, fringe benefits are paid for all hours worked, including overtime. However, cash payments of the fringe are not included in the base rate when calculating the overtime rate (one and one half the base rate). As mentioned earlier, state laws vary, and some consider cash payments of the fringe as part of the base rate, which would affect overtime in that state.

The list of pitfalls doesn’t end with overtime. A perfect example of another conflicting signal occurs when employers attempt to provide prevailing wage-covered employees with transportation benefits. Recently, some states have recognized “commuter benefits” as appropriate from a fringe benefit perspective. This can be very misleading. For example, IRS regulations say that employer-paid travel expenses are limited to: a ride in a commuter highway vehicle between the employee’s home and work place; a transit pass; and qualified parking. Transportation benefits can be excluded from the employee’s wages if they don’t exceed \$110 per month for combined commuter vehicle transportation and transit passes and up to \$215 per month for qualified parking. The IRS does not provide an exception for personal commuter mileage reimbursement.

The lesson learned here is not that the state is wrong in regards to their prevailing wage requirements, but rather that a benefit may be appropriate from one office’s perspective but inappropriate from another. While a mileage reimbursement commuter benefit may be considered by the state as an appropriate benefit under their prevailing wage law, it could at the same time be subject to federal income tax.

What does this mean for the construction business owner? Depending on where a project is located and whether it is a state or federal project determines which law comes into play. This can be very confusing to the contractor when they have projects in multiple states and where they are doing both state and federal projects. By adopting a bona fide fringe benefit program, the construction business owner receives unmatched professional expertise in the areas of administration, support, technical advice and flexibility to meet their needs. Some providers cater exclusively to the construction and service industries and as a result, understand the special needs of their clients. Construction companies have unique concerns that cannot be addressed with typical "off-the-shelf" plans. For example, they often have a workforce that turns over, jobsites that may be spread across a wide geographic region, a very diverse workforce, both culturally and educationally, and may even speak several languages.

What Happens If You Are Audited?

While construction business owners want to be compliant, they also want to avoid an audit of their benefits program at any level. The U.S. Department of Labor, its state equivalent and the IRS conduct audits or investigations. The IRS conducts audits regarding the operation of a retirement plan and if it is operating according to the plan document and in a qualified manner. The U.S. Department of Labor Employee Benefits Security Administration investigates in this area also. The U.S. Department of Labor Wage and Hour Division and their state equivalents conduct audits and investigations relating to the Davis-Bacon Act and state prevailing wage laws.

Either the contracting agency or the Department of Labor may initiate an investigation. The audit may be routine or triggered by an employee or a union complaint. In the audit process, a compliance officer will check to see if the wage determination is posted at the jobsite. The officer will then determine if the correct wage rate was paid for the work.

The investigation begins with an opening conference between the compliance officer and a company representative. The compliance officer will request certain records such as certified payroll reports, actual payroll records, records of fringe benefit contributions and copies of trust documents establishing fringe benefits. The compliance officer may also talk with the craft workers. Usually within a week or two, the contractor will be advised of the audit results.

If no violations are found, the contractor will receive a letter or phone call. In the event of violations, the compliance officer will meet with the contractor and explain the violations and request payment of back wage and/or benefits and an agreement to comply in the future. If the contractor agrees and complies, that will end the compliance review unless debarment procedures are initiated. If agreement is not reached, payments due the contractor may be withheld until such time as the matter is finally resolved.

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Common Issues Reviewed by Audits/Investigations

- Was each laborer and mechanic paid the proper predetermined prevailing wage and fringe benefits for the classification of work performed?
- Did employees receive one and one-half their basic rates of pay for hours worked on the contract over forty per week?
- Are the classifications correct?
- Did the contractor use a disproportionate number of laborers and/or apprentices or trainees?
- Did the firm make contributions to bona fide fringe benefit plans that were creditable toward meeting the prevailing wage requirements?

For a plan to be bona fide, the contributions have to be irrevocably made by the contractor or subcontractor to a trustee or third party pursuant to a bona fide fringe benefit fund, plan or program. The rate of costs to the contractor must be reasonably anticipated in providing bona fide fringe benefits pursuant to an enforceable commitment to carry out a financially responsible plan or program, which was communicated in writing to the employees. Contributions to fringe benefit plans must be made regularly—not less often than quarterly.

A retirement plan must meet the ERISA requirements to be bona fide. Credit cannot be taken for fringe benefit contributions made on behalf of employees who are not eligible to participate in the plan. If a retirement plan has a vesting schedule, the same percentage contribution will need to be made for all work, both public and private, for the year. However, if contributions into a retirement plan are 100 percent vested, then under the Davis-Bacon Act rules and in many states, a contractor can take full credit toward the wage determination even if they only contribute on prevailing wage work and not on private work.

In addition to the bona fide plan rules, contractors and subcontractors must maintain basic payroll records during the course of the work and preserve them for three years for federal projects. Some states vary the holding period for records. Federally and in most states, the contractor must submit certified payroll records weekly to the contracting agency. These are submitted on a form provided by the states or the U.S. Department of Labor.

Tim Heffner is president of DESCCO, which is a general contractor employing about twenty-two people, headquartered in Fleetwood, PA. He says, “Utilizing a fringe benefit plan has helped us save tremendously on payroll taxes and simultaneously provided a retirement program for our employees by helping them put something aside for their retirement. When we first implemented the plan, there was a bit of complaining, because the employees were used to seeing the fringe amount in their take-home pay, but today, some of those employees have six-figure sums in their retirement accounts.”

The company survived a state audit last year, and Tim credits their computerized system for making the audit process relatively painless. “It was the first time we had ever been audited, but fortunately we had all the necessary documentation easily available.”

For the construction business owner working in the government contracting arena, there is an added layer of compliance as compared to private work, but the rewards can be worth it. Benefits service companies offer owners years of experience and fringe benefit plans to make the contractor’s job easier in bidding for government work and remaining compliant after they get the job.

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