 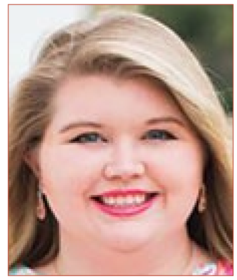

Competitive and Cost-Conscious Contracting: The Importance of Fringe Benefits

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Federal government contracting is constantly evolving and presenting new challenges for contractors competing to support government missions. There are three primary objectives that companies operating under the McNamara O'Hara Service Contract Act of 1965 and the construction-related Davis-Bacon Act of 1935 are striving for: contract compliance, cost-effectiveness that is profitable to the company bottom line, and—most importantly—being competitive to win the work.

One of the provisions in both laws provides built-in cost savings opportunity for the contractor. A contractor can provide "bona fide" fringe benefits where mandated by contract provisions, thus putting the contractor at a cost-saving advantage over the competition that is not providing fringe benefits.

However, these fringe benefit contract requirements under the Service Contract Act and the Davis-Bacon Act present contractors with a challenge. Similar to wage determinations, specific fringe benefits requirements are required to be paid on an hourly basis, although the fringe rates vary under both acts. Employees working under contracts governed by a particular Act that has a specified fringe rate must receive that fringe rate either as cash paid out or as the benefit equivalent, always in excess of their base wages.

For example, the contractor can pay the designated fringe rate into bona fide fringe benefits. Health and welfare benefits such as group health plans, dental plans, additional sick leave days, or retirement options are some examples of these "bona fide" fringe benefits.

A common method of properly discharging fringe dollars is the "hours worked" method. Under this mode, the contractor is responsible for reporting employee hours worked and must pay the designated hourly fringe rate accordingly. Most of the time, contractors address the fringe benefit obligation by paying the fringe dollars to the employee, in cash. Seems like the right choice because it's a simple process and calculation, right? Wrong.

The contractor that is paying the fringe into a bona fide fringe benefit maintains a competitive financial tax advantage over a contractor that is paying fringe dollars into cash. Additionally, the contractor may choose a number of different options that satisfy the federal requirements.

When contractors utilize those fringe dollars to provide employee benefits, the advantages go way beyond cost-effectiveness; employee fringe benefit plans often translate to a healthier workforce and reduced absenteeism, in addition to increased employee satisfaction and productivity.

Regardless of the method, the specific fringe benefit payments must be accounted for separately to ensure compliance.

You might ask, "Why would a contractor choose to provide benefits, instead of the more direct cash payout?" While different situations provide for different company needs, it is not uncommon for groups that pay cash in lieu of benefits do so in order to meet local wage demands. Paying the fringe into bona fide benefits plans provides a boon to the employee while also providing the contractor with a small advantage over the competition.

When the contractor elects to pay cash in lieu of benefits, the contractor takes on additional payroll tax burdens. This usually manifests in the form of increased premiums for workers compensation and an increase in FICA and state taxes. Contractors working under the Acts that decide to pay the fringe rate in cash will have an additional burden that their competitor, who pays the obligated fringe as a "bona fide" fringe benefit, simply does not.

Our recommendation? Outsource fringe benefits via a third party that provides benefits for the employees working the contract.

Contractors could always handle the administration themselves, but that would require the expertise and resources to properly track and account for those fringe dollars at the individual employee level. That level of accounting is mandatory for contractor compliance and, frankly, many employers just don't have the juice.

But there are many companies that develop benefit plans that are designed to meet the specific needs of government contractors.

In the federal contracting world, there are clear winners and losers. What separates the two could be a very small dollar differential. In this arena, it will be the competitive and cost-conscious contractor that succeeds. ■