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100 Overview

Construction Industry

100.1 The construction industry is one of the largest segments of the American economy. It employs more people, contributes more to the gross national product, and consumes more raw materials than any other single industry. The thousands of companies that compete in this industry range in size and sophistication from the “father and son” remodelers who operate out of the back of their pickup trucks to multinational contractors that specialize in projects costing millions of dollars and employing hundreds—even thousands—of workers.

100.2 This segment of the economy has also spawned related industries that would not exist if not for the construction industry. Companies that manufacture and deliver the raw materials used by contractors, provide financing for new projects, guarantee project completion by issuing various types of bonds, and provide a host of other services specifically to the construction industry that help ensure the prominence of this industry in the overall economy.

100.3 A great deal of information on the construction industry may be found on the Internet. The following government websites contain a variety of information such as current statistics on new construction:

- U.S. Census Bureau (**www.census.gov**)
- Bureau of Labor Statistics (**www.bls.gov/iag**)
- Department of Commerce (**www.commerce.gov**)
- United States Environmental Protection Agency (**www.epa.gov**)
- Occupational Safety & Health Administration (**www.osha.gov**)
- Internal Revenue Service (**www.irs.gov**)

There are also a number of construction-related websites that are listed in section 108 and Appendix 5A.

Tax Issues

100.4 The industry has many accounting and tax issues, some of which are shared with other industries and some are unique to the construction industry. One issue that is common to most industries is the choice of business entity (see Chapter 6). While there are advantages and disadvantages to each form of doing business, protecting the owner(s) from liability is a major concern. Not only can there be potential liability for physical or economic harm during the construction phase, but lawsuits alleging faulty or negligent construction can be brought long after the construction is finished.

100.5 One of the longest running controversies within the construction industry involves the use of the cash versus the accrual basis of accounting. By using the cash method of accounting, contractors can defer revenue recognition until the cash is received versus the year the income is earned, as determined by the accrual method. The deferral of revenue, coupled with the simplicity of the cash method, make this option very desirable. Chapter 3 contains a discussion on this topic as well as summaries of IRS announcements regarding availability of the cash method and summaries of numerous court cases involving cash versus accrual-method issues related to construction contractors.

100.6 Even if the accrual method is used, another major issue arises—use of the percentage-of-completion or the completed-contract method for reporting income from long-term contracts. Since the completed-contract method defers any income until the underlying contract is completed, it is the preferred method for tax purposes. However, many contractors are prohibited from using the completed-contract method. A related issue concerns the alternative minimum tax (AMT), which requires most taxpayers, including contractors, to compute their taxable income and tax due under both the regular tax and AMT systems, and then pay the larger of the two. For contractors, an important aspect of the AMT is the requirement that contract income be computed using the percentage-of-completion method. Various issues surrounding the taxation of long-term contracts are discussed in Chapters 2, 3, and 4.

100.7 Other significant income tax issues are discussed in Chapter 7, including whether equipment expenditures are deductible as repairs or must be capitalized and depreciated. While a Section 179 deduction can eliminate some of this problem, the issue is critical for site contractors who have a large investment in equipment. Furthermore, the construction industry has the usual issues of personal use of company assets, loans to shareholders and, of course, unreasonable compensation.

100.8 Another issue that contractors regularly face is whether to classify workers as employees or as independent contractors (see section 701). It comes as no great surprise that many contractors prefer to classify their workers as independent contractors for a variety of tax and nontax reasons, while the IRS believes that most construction workers should be classified as employees.

100.9 The complexity of the construction industry provides an IRS revenue agent with countless issues to raise during an examination. To help revenue agents recognize and develop the appropriate issues, the IRS has issued a *Construction Industry Audit Technique Guide* (ATG).[1] The ATG is discussed in several places within this *Guide*. Practitioners should assume that the revenue agent has read the ATG before the audit, and will be focusing on the issues raised in the ATG.

100.10 Another issue practitioners must consider when providing bookkeeping, payroll, tax, or other nonattest services to attest clients is AICPA Ethics Interpretation 101-3 (ET 101.05), “Performance of Nonattest Services.” Attest services include any engagement that requires the practitioner to be independent. Thus, attest services include not only audits, but also reviews, compilations, and agreed-upon procedures engagements. (A compilation can actually be performed without independence; however, when this is the case, the practitioner's lack of independence must be stated in the report.) Interpretation 101-3 contains the responsibilities of a practitioner for maintaining independence when providing nonattest services to attest clients. Among other things, Interpretation 101-3 requires the client to agree to perform certain functions and the firm to document specific items relating to the nonattest services. For further information regarding Interpretation 101-3, practitioners can refer to *PPC's Guide to Construction Contractors* or to the professional ethics section of the AICPA website at **www.aicpa.org**.

100.11 Since 2007, there has been a tax-related financial reporting requirement for businesses that issue financial statements based on generally accepted accounting principles (GAAP). Any issuer of GAAP-based financial statements is required to disclose in the financial statements income tax benefits reported on the issuer's tax return that are not likely to be sustained on audit. In short, unless a tax position is more-likely-than-not, the tax benefits cannot be recognized for financial statement purposes, thus creating a difference between the tax liability shown on the return and the recomputed liability shown on the financial statements. This has raised some concern within the accounting community that the publicly available GAAP disclosures may provide the IRS a roadmap to audit agents for sensitive or aggressive tax issues. See section 712 for further discussion on accounting for uncertainty in income taxes.

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[1] The ATG was the first in-depth guide for examiners that set forth the IRS positions relative to many construction contractor issues, including allowable methods of accounting. The ATG is intended to be both an in-depth guide for tax examiners conducting audits in the construction industry and an information tool for taxpayers and practitioners associated with the construction industry. The ATG can be found on the IRS website at **www.irs.gov**.

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101 Content and Organization of This *Guide*

101.1 The number of tax issues that may be faced by contractors is almost as large as the construction industry itself. Tax laws differ for contractors depending on their size and the type of contract involved. This *Guide* has been developed to address the tax needs of each type of construction contractor. Both internal accountants and independent CPAs serving the construction industry will benefit from using this *Guide*, which includes discussions of the following topics:

- *Chapter 1—"Introduction"*presents an overview of the construction industry and the tax laws governing construction contractors. Descriptions are also given of the participants involved in construction and the construction process itself. The role of special-purpose entities in the construction industry and current issues being challenged by the IRS are also discussed. Finally, contact information for some of the larger construction-related associations is presented.

- *Chapter 2—"Large Contractors"*discusses the statutory rules and regulations relating to construction contractors that are subject to the rules of IRC Sec. 460. These contractors are commonly referred to as "large contractors." Large contractors are contractors with average annual gross receipts for the three preceding tax years of more than $10 million. This chapter includes guidance on the method of accounting for long-term contracts by large contractors, the allocation and capitalization of costs, as well as a discussion of the look-back provisions of IRC Sec. 460.

- *Chapter 3—"Small Contractors"*discusses the statutory rules and regulations relating to the contracts of "small" construction contractors that are exempt from the rules of IRC Sec. 460. This chapter includes guidance on the methods of accounting available to small contractors, the allocation and capitalization of costs, the calculation of the alternative minimum tax, and discussions on IRS audit issues for small contractors.

- *Chapter 4—"Home Construction Contracts"*discusses the statutory rules and regulations relating to home and residential construction contracts, which are also exempt from IRC Sec. 460. This chapter includes guidance on the appropriate tax accounting and cost allocation methods for reporting income and expenses of home and residential construction contracts to the IRS. Guidance is also presented for those contractors that function as developers of real estate.

- *Chapter 5—"Specialty Contractors"*discusses the tax reporting and compliance issues specific to specialty contractors, which are commonly referred to as subcontractors. These issues include when and how to report retainage, how to report employee travel and expense reimbursement, and tax credits available to certain subcontractors.

- *Chapter 6—"Entity Issues"*focuses on contractor-specific issues involving C corporations, S corporations, partnerships/joint ventures, sole proprietorships, limited liability companies (LLCs), and limited liability partnerships (LLPs).

- *Chapter 7—"Other Tax Issues"*addresses tax planning and compliance issues that construction contractors may face other than accounting for long-term contracts. This chapter includes guidance on employment tax concerns with the classification of workers, treatment of equipment costs, determining and documenting "reasonable" owner compensation, the use of deferred compensation, making and reporting entity loans to and from shareholders, treatment of rent expense between an owner and the business, and avoiding accumulated earnings tax. Finally, this chapter addresses the required procedures to follow when electing or changing an accounting method, some of the issues involved when operating in multiple jurisdictions, the effect of the domestic production activities deduction on construction contractors, and the effect on construction contractors of generally accepted accounting principles (GAAP) related to accounting for uncertainty in income taxes.

101.2 This *Guide* contains numerous examples and exhibits illustrating the concepts discussed. For the user's convenience, the final two appendixes in each chapter contain indexes of all the examples and exhibits within that chapter. The appendixes include the example or exhibit number, a description of the example or exhibit, and the page in the *Guide* on which the example or exhibit appears.

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102 Participants in the Construction Industry

102.1 The construction industry has many participants including owners, architects, engineers, contractors, subcontractors, construction managers, developer-contractors, suppliers, tradesmen, inspectors, and sureties. All of these participants play an important role in the construction process; however, the discussion that follows is limited to those who directly participate in the contracting and bonding process.

Owner

102.2 The owner, who may be an individual, partnership, LLC, corporation, or governmental unit, conceives and initiates the construction project. After obtaining the necessary financing, the owner contracts with others to design and build the structure. The owner has legal title to the project throughout the construction period (subject to liens normally filed by the financial institution that provides funding and the general and subcontractors who work on the project).

Design Professionals

102.3 The owner engages design professionals (such as architects or engineers) to design the structure to be built. When the structure being designed is a building, the design professional will generally be an architect. When the structure is something other than a building (for example, a road or a bridge), the design professional will usually be an engineer.

Contractors

102.4 Depending on the type of work they perform, contractors can be classified as either highway, heavy construction, or general building. The characteristics of each type of contractor are described below.

102.5 **Highway Contractors**

Highway contractors are engaged by owners to build roads, streets, bridges, and airports. While most highway construction contractors provide services to a branch of the federal, state, county, or municipal government, these contractors may also work for independent private developers to build streets, curbs, gutters, and sidewalks for new commercial or residential developments.

102.6 **Heavy Construction Contractors**

This type of contractor is involved in large earth-moving projects and the building of foundations, dams, tunnels, bridges, and power plants. Typically, heavy construction contractors have a significant investment in equipment and employ hundreds of workers on each project. Many of these contractors are very large companies with both domestic and international operations.

102.7 **General Building Contractors**

The largest category of contractor is the general building contractor. These contractors erect or remodel virtually every kind of residential, industrial, and commercial shelter, including office buildings, manufacturing facilities, shopping centers, single-family residences, apartment complexes, medical facilities, and the like. General building contractors fall into the following two major categories:

a. *General Contractors.* By contract with the owner, general contractors are responsible for all of the work on a project. Generally, they subcontract out a substantial part of the work while maintaining overall control through project managers and on-site supervision.

b. *Subcontractors.* Subcontractors usually contract directly with the general contractor, but may contract with the owner or a developer-builder in certain situations. Subcontractors confine their work to a special facet of building (known as a trade) such as, electrical, plumbing, air-conditioning, roofing, painting, glazing (glass work), drywall, carpeting, tile setting, and other major construction components. Subcontractors often work for other subcontractors. For example, a sheet metal contractor may provide and install the metal duct work for the air-conditioning subcontractor.

Construction Manager

102.8 The construction manager is the owner's agent and may be engaged in lieu of or in addition to a general contractor. As the owner's agent, the construction manager coordinates the construction project but has no contractual relationship with subcontractors and, generally, does not perform any construction work on the project.

Developer-contractor

102.9 The developer-contractor frequently has an agency relationship with the owner, much like the construction manager, but may have a partial or 100% ownership interest in the project under construction. In either case, the developer-contractor offers a broader range of services than the construction manager.

Sureties

102.10 Sureties are generally insurance companies that guarantee the contractor/principals will do what they have contracted to do, and if they do not, the surety will be responsible for carrying out the contractor's responsibilities. Contractors are required to submit detailed financial statements to the surety before the appropriate bonds can be secured. (Details on the types of financial statements and supporting schedules that may be reported to sureties are included in *PPC's Guide to Construction Contractors*.) There are four common types of bonds used by contractors: bid bonds, performance bonds, payment bonds, and combination performance and payment bonds.

102.11 **Bid Bonds**

Bid bonds guarantee that upon award of a contract, the contractor will, within a specified time after the award, sign the contract and furnish the required performance and payment bonds. The bid bond is always a small percentage of the bid (generally 3%). The surety usually does not charge for a bid bond.

102.12 **Performance Bonds**

Performance bonds protect the owner from loss resulting from the contractor's failure to complete the work in accordance with plans and specifications. These bonds are usually a percentage of the contract amount.

102.13 **Payment Bonds**

Payment bonds guarantee payment of all bills received by the contractor for labor and materials for the work. In some states, there are statutes requiring a separate payment bond on public contracts, which may be referred to as statutory bonds.

102.14 **Combination Performance and Payment Bonds**

This bond is a single bond used for private contracts that combines the performance and payment bonds mentioned above.

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103 Overview of the Construction Methods or Approaches

103.1 Because of the significance of the investment, the owner of a project normally has a strong incentive to complete the project as efficiently as possible. However, the construction process can be very complex and difficult for an owner to control. Materials must be purchased for the lowest cost from reliable vendors who can ensure delivery to the job site at the proper time. A delivery made too late can cause costly construction delays, while materials that arrive too early may be subject to theft, weather damage, or other loss. Skilled employees, such as architects, tradesmen, job site supervisors, and inspectors must be hired, and their efforts must be coordinated so they start at the proper times. Someone must work with the city zoning department and building inspectors, labor union representatives, and a host of other outsiders to ensure project completion. The construction process is so complex, it is little wonder that most owners choose to employ specialists to ensure timely completion of a project. The specialist most often used is a general contractor.

103.2 Three primary construction management methods have evolved to assist the owner in controlling a project: the traditional bid method, the construction management approach, and the developer-contractor approach. Each of these are discussed in the following paragraphs.

Traditional Bid Method

103.3 **Description**

The traditional bid method (also known as the design-bid-build method) is frequently used today. Under this method, the owner typically hires an architect or engineer to design a project. The design professional, with input from the owner, develops a project concept that is reduced to a set of plans and specifications. After the design has been totally completed, the plans and specifications are distributed to general contractors for competitive lump-sum bids. The owner generally awards the contract to either the lowest qualified bidder or the bidder who negotiated an arrangement that best suits the owner and provides the best value (which may not necessarily be the lowest bid). The bidder awarded the contract is responsible for purchasing the materials, hiring subcontractors and other specialists, coordinating the efforts of the construction team, and doing whatever is required to complete the project on time and within budget. When the traditional bid method is used, the owner contracts directly with the architect and the contractor.

103.4 There is no contractual relationship between the architect and the contractor, but the architect is expected to review and approve the work of the contractor. Also, the architect is often the referee when disputes arise regarding the contract or design document. The owner is responsible for the final selection of the contractor, the duration of the project, the approval of progress payments, extras or changes, and the final resolution of disputes or claims.

103.5 **Strengths and Weaknesses**

From the owner's perspective, the major strengths of the traditional bid method involve the ability to (a) establish or define the cost of the project early in the process and (b) assign much of the risk associated with the project to the contractor. However, these benefits may be largely offset by some inherent weaknesses in the method, such as—

a. Overall project time is generally longer than for other methods because project design must be complete before bids can be taken and construction begun.

b. Actual bids are sometimes greater than preliminary estimates by the design professional, requiring redesign to stay within budget and causing further delays.

c. Contractors are largely driven by the desire to minimize cost whereas design professionals tend to focus more on quality and aesthetics. These conflicting motives increase the potential for contract claims.

d. Although the owner may have awarded the contract to the general contractor with the lowest bid, the lowest cost may not be realized. The general contractor will usually place a contingency amount within the bid as a hedge against the risk of the unknown. If the unknown risk is not experienced, this contingency becomes additional profit to the contractor, not savings to the owner.

103.6 **Risk to the Contractor**

Contractors usually obtain construction contracts through a competitive bidding process. Although this process reduces the risk of future price increases to the owner, it generally increases the risk to the contractor. Once a bid has been accepted by the owner, the contractor is expected to complete the project for the proposed price (subject to any change orders or extras), even if the project costs the contractor more than anticipated.

103.7 Before general contractors submit bids to a project owner, they must develop a thorough understanding of the plans and specifications for the project. To ensure the project can be completed at a profit, the general contractors must make sure that all costs are included in their estimates. Direct costs, such as materials, labor, and subcontract costs, can, in most cases, be accurately estimated and included. Other costs such as overhead and interest are less obvious but must still be considered. Thus, the costs incurred and time spent preparing bids can be significant.

103.8 The general contractors must also know their competitors before submitting their bids. If bidders are competing against firms with higher than normal overhead, they may be able to increase the profit factor in their proposals while still remaining competitive. On the other hand, many companies have a reputation for "low-balling" bids, that is, deliberately bidding lower than cost to get a job with the knowledge that they can turn a profit through change orders and extras during the project.

Construction Management Approach

103.9 **Description**

Although still a very popular method of obtaining construction projects, the traditional bid method has its shortcomings. During periods of inflation and/or rapidly increasing construction costs, it becomes difficult for contractors to realize their estimated profit under the traditional bid method on projects that take more than half a year to complete. Accordingly, the construction management approach is increasingly used if the timing of project completion is important.

103.10 The construction management approach introduces a professional consultant—the construction manager (CM)—to the construction team. The CM is involved in all phases of a project, usually taking the place of the traditional general contractor. The CM becomes an agent for the owner and controls the project from early design to move-in. The CM, usually a professional engineer, development firm, or architect by experience; assists the owner in evaluating financial feasibility, developing realistic budgets and schedules, and evaluating cost-effective solutions.

103.11 The construction management approach is especially useful for larger, more complex projects that may be beyond the capabilities of most general contractors. Depending on the project size, the CM may recommend hiring individual subcontractors, project managers, and on-site supervisors to build the project. Alternatively, the CM may recommend hiring a general contractor who has an established set of subcontractors and the ability to provide job-site management and supervision.

103.12 **Strengths and Weaknesses**

If project timing is of paramount importance, the construction management method facilitates a fast-track approach to building, whereby construction can be initiated before the total building plans are complete. Design then progresses just ahead of the various phases of construction. By overlapping the design and construction schedule, significant time can be saved and the overall design/construction schedule compressed. The result can be earlier completion and occupancy and less cost. Additionally, during periods of rapidly escalating construction costs, compressing the time required to complete the contract also produces savings.

103.13 When this approach is employed, there is a risk of cost overruns and unmet deadlines. Since construction often starts before the plans and specifications are complete, some procedures may need to be redone or may not have been required at all. Also, a CM generally will not provide the owner with the same degree of price protection as a general contractor. Under a lump-sum contract with a general contractor, an owner typically knows what the cost of the project will be before construction begins. This is generally not the case under the construction management approach.

Developer-contractor Approach

103.14 **Description**

The developer-contractor offers perhaps the most complete set of project or construction services available to an owner. The developer-contractor, when engaged on a fee basis, functions much like the construction manager, that is, as an agent for the owner. In many cases, the developer is also the contractor, so the owner is provided even greater control over the design, cost, and schedule of a project. The services provided by the developer-contractor generally include the following:

a. *Site Selection and Acquisition.* This activity includes analysis of alternative sites, market study and feasibility analysis, development of new streets, if required, working with municipalities to accomplish rezoning, replatting, and bringing utilities to the site. This also includes contracting for the site with sufficient contingencies to make sure it can be properly developed to accommodate the intended project.

b. *Total Project Feasibility Analysis.* Besides an analysis of the building and construction costs, this service will include such items as: costs of land closing and title work, interim and permanent financing costs, negative cash flow during absorption or lease-up period, leasing and finish-out costs for tenants, and a complete project cash flow projection.

c. *Ownership Structuring.* The ownership structure can be simple, with one or two owners, but larger projects often require complex structuring. In addition to the entrepreneur and the developer, ownership may include the lender or one or more major tenants of the prospective structure. Additionally, financing may require bringing in outside funding through private placement or public funding.

d. *Arrangement of Interim and Long-term Financing.* A good developer will have knowledge of sources of funds and a track record for bringing the most favorable funding to a project. This includes the interim funds required during the construction process and the long-term or mortgage funds needed upon completion of a project.

e. *Structuring a Lease Program for Projects That Have Speculative Space That Is Not Pre-leased by Tenants.* Frequently, the structures built using developer-contractors include excess capacity or speculative space to be leased by the owner. In these cases, the developer-contractor will usually have the knowledge and expertise to design a leasing program for the owner.

f. *Arranging and Contracting for Management of the Completed Project.* This includes such functions as the collection of rent, maintenance, landscaping, and garbage pickup.

103.15 The developer-contractor is sometimes referred to as the package builder, or turn-key contractor, who is responsible for a project from conception to completion. As with the construction manager, the developer-contractor is active throughout the design phase to ensure that the project can be completed with the available funds. The developer-contractor is also involved throughout the construction process to ensure its timely completion within budget.

Design-build Method

103.16 **Description of the Design-build Method**

Design-build is a construction project delivery method in which one entity, the design-build team, works under a single contract with the owner to provide design and construction services. Most often, a construction company combines with an architectural or engineering (A/E) firm to contract for a design-build project. The combination of the construction company and the A/E firm often occurs through a joint business venture, such as a joint venture, a corporation, or a limited liability company (although other business structures are also used). Given the amount of effort involved in forming a new business structure, this project delivery method is generally used for large construction projects. Additionally, it is not uncommon for the business structure to remain intact for more than one project.

103.17 Use of the design-build methodology has greatly accelerated since the early 1990's making it a significant trend in design and construction. A report released in 2011 indicated that design-build project delivery is now used for more than 40 percent of nonresidential construction projects.

103.18 **Pros and Cons of the Design-build Method**

The design-build method transforms the relationship between designers and builders, which is often adversarial in other construction methods, into an alliance that fosters collaboration and teamwork. That fundamental change allows work to be completed faster with fewer problems, and has resulted in far less litigation between the contractor and the A/E when the design-build method is used, as compared to other methods.

103.19 Additionally, an integrated team is more geared toward efficiency, innovation, and quality. The collaboration of the team often results in a better project than was initially imagined. Similar to the construction management approach, construction can be initiated before building design is complete, thereby allowing for faster completion of the project.

103.20 Due to the single point of responsibility for the project, risk is minimized for the project owner, and the owner avoids being placed directly between the A/E and the contractor. The design-build method places the responsibility for design errors and omission on the design-builder, which is an advantage for the owner who is relieved of major legal and managerial responsibilities. However, the burden for those costs and associated risks is transferred to the design-build team.

103.21 While the design-build method has been used successfully for over a decade now, a few public scandals have created some concern about the use of this method. The concern has centered on the lack of competitive bidding, which may result in certain subjective decisions, including contractor and subcontractor selection. Additionally, the design and price selected may arouse public suspicion, which can lead to a loss of public confidence. Those issues have been more of a concern for government-funded projects.

Public Private Ventures or Build-own-operate Approach

103.22 Two similar but somewhat different methods of construction are known as Public Private Ventures (PPVs) or Build-own-operate. In these construction methods, the contractor will generally work with a public entity to provide not only the construction of the project, but the financing for the project, and in many cases also provide design-build services. The contractor will become part of an ownership team that may also operate the final project and collect revenues from the project as an investment rather than being paid for the construction of the project.

103.23 This contracting method is significantly more risky to the contractor. The contractor can mitigate its risk by finding a financial partner that is willing to take on the ownership portion of the project and pay the contractor for the services performed on a typical construction contract basis.

Summary

103.24 All of these approaches are successfully used in construction contracting. The most appropriate method for any given project depends on its unique set of facts and circumstances.

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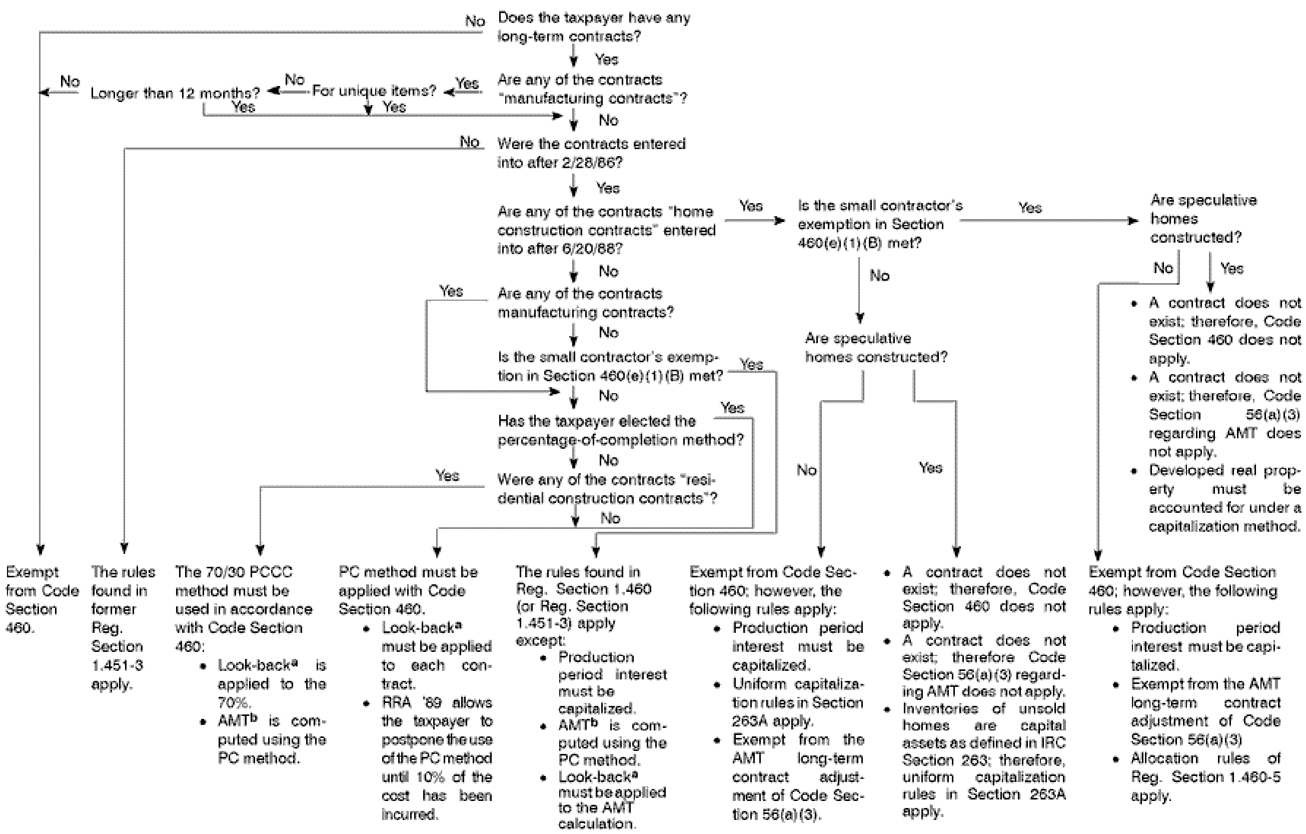
104 Overview of the Tax Law

104.1 Before discussing the detailed aspects of tax law for contractors, a general overview helps to create a foundation for understanding the rules. Exhibit 1-1 summarizes the primary tax rules for long-term contracts, and the following paragraphs elaborate on the issues presented in that exhibit. These issues are then discussed further in Chapters 2, 3, 4, and 5.

Exhibit 1-1

Application of IRC Sec. 460



Notes:

[a] Taxpayers may elect out of look-back in certain situations. See paragraph 210.14. Also, taxpayers who have elected the 10% method are not subject to look-back until the contract is 10% complete (based on final contract costs). See paragraph 210.19.

[b] The 1997 Taxpayer Relief Act exempts "small corporations" from AMT, as discussed at paragraphs 209.7 and 304.5.

Does the Taxpayer Have Any Long-term Contracts?

104.2 The tax definition of a long-term contract is found at IRC Sec. 460(f)(1).

> The term “long-term contract” means any contract for the manufacture, building, installation, or construction of property if such contract is not completed within the taxable year in which such contract is entered into.

Traditionally, a long-term contract is thought of as a project that takes longer than one year to complete. However, the definition in IRC Sec. 460 only requires that the contract be in progress at the taxpayer's year end. The contract is “in progress” if any cost (other than costs related to bidding or negotiating the contract) chargeable to the contract has been incurred. [2]

104.3 ***De Minimis*** **Construction Activity**

Contracts with *de minimis* construction activity are not long-term construction contracts. Reg. 1.460-1(b)(2)(ii) states that where the contract includes land and the total allocable contract costs as defined under Reg. 1.460-5 (including a proportionate share of common area costs) are less than 10% of the contract's total price, the contract is not a construction contract under IRC Sec. 460.

Are Any of the Contracts ***Manufacturing Contracts*****?**

104.4 IRC Sec. 460 makes a distinction between two general categories of long-term contracts: construction contracts and manufacturing contracts. The distinction can be interpreted as follows:

- *Construction Contract.* A construction contract includes the building, construction, reconstruction, rehabilitation of, or installation of any integral component to, or improvements of, real property. The term real property includes buildings, dams, roads, or similar property.

- *Manufacturing Contract.* A manufacturing contract is a contract to fabricate, produce, or build an item of personal property, such as aircraft, furniture, apparel, etc.

104.5 Based on the general definition of a long-term contract in paragraph 104.2, any contract that is in progress at a taxpayer's year end could potentially be categorized as a long-term contract. However, IRC Sec. 460(f)(2) contains certain exceptions that, if met, give many manufacturers relief from the long-term contract rules. The special rule for manufacturing contracts states that a contract is not a long-term contract unless it involves the manufacture of:

a. any unique item not normally carried in the taxpayer's finished goods inventory, or

b. any item that normally requires more than 12 months to complete (regardless of the contract's duration).

104.6 While many traditional manufacturers are exempt from IRC Sec. 460, others (especially job shop manufacturers) may have jobs in progress at year end that are subject to the long-term contract rules. The major defenses for those contractors are to argue that the item being manufactured is not unique or that it is normally completed in 12 months.

104.7 Under the final Section 460 regulations, an item is not unique, even if it meets the definition of “unique,” if [Reg. 1.460-2(b)]:

- It normally requires 90 days or less to complete.

- 10% or less of the estimated total costs of the item are attributable to customizing the item. Customization costs include research, development, design, engineering, retooling, and other similar activities.

- The taxpayer begins to carry the item in inventory in the normal course of business.

Example 1-1: Short-term construction period safe harbor.

Lugnut Manufacturing, LLC manufactures inventory retrieval systems. The normal system takes 80 days to complete. On November 1, 20X1, Lugnut contracts with a customer to deliver two retrieval systems on February 1, 20X2. The units do not require any significant customization so the estimated costs for customization are less than 3%. Due to delays in the production process at Lugnut, the units are not completed and delivered until 110 days have passed. Since the units did not require significant customization and the normal production period is less than 90 days, the contract will meet the safe harbor, and is not a long-term contract.

104.8 It should be noted that delaying the sale of an item will not circumvent the rules, since the production period ends when all reasonably expected production activities have been completed. If component items are involved, the production period ends when the items have been incorporated into the item.

104.9 Related parties complicate the determination of the production period. Generally, a related party's production time is included in determining whether the 12-month test is met. However, the production period of related parties need not be considered if 50% of the average annual gross receipts attributable to the sale of the item for the 3-taxable-year period ending with the contracting year are to unrelated parties.

Example 1-2: Related party production period.

Hoist, Inc., builds cranes, which it normally keeps in its finished goods inventory. The cranes usually require about nine months to produce. The crane's integral components are produced by Welift, Inc., a company related to Hoist, Inc. The components normally take five months to produce at Welift and are not carried in Welift's inventory. Welift begins construction on May 1, 20X1, and delivers the components to Hoist on September 30, 20X1. Hoist begins construction of the crane on October 1, 20X1, with the crane completed on June 30, 20X2.

Since Hoist and Welift are related parties, their production periods must be combined in determining whether this is a long-term contract. Since Welift's production period was five months and Hoist's construction period was nine months, there is a total production period of 14 months. Since the contract was not completed within the taxable year and the item normally takes more then 12 months (14 months in fact) to produce, the contract is a long-term contract.

104.10 See Section III of IRS Notice 89-15 for additional guidance on determining whether a manufacturing contract is exempt from IRC Sec. 460. The small contractor exemption does not apply to manufacturers.

Were the Contracts Entered into after February 28, 1986?

104.11 The effective date for applying both the contract accounting rules in IRC Sec. 460 and the alternative minimum tax rules of IRC Sec. 56(a)(3) was February 28, 1986. All contracts entered into after this date are subject to those rules. Contracts entered into before March 1, 1986, are subject to the long-term contract rules of IRC Sec. 451 and prior Reg. 1.451-3.

Are Any of the Contracts *Home Construction Contracts*?

104.12 The Technical and Miscellaneous Revenue Act of 1988 (TAMRA '88) granted special exemptions for home construction contracts entered into on or after June 21, 1988. For purposes of those exemptions, a home construction contract is defined as follows:

A home construction contract is any contract where 80% or more of the estimated total contract costs (as of the close of the tax year that the contract was entered into) are reasonably expected to be attributed to the building, construction, reconstruction, or rehabilitation of:

- dwelling units contained in buildings containing four or fewer dwelling units (with each townhouse treated as a separate building), and

- improvements to real property directly related to such dwelling units and located on the site of such dwelling units.

The type and degree of exemption from the long-term contract rules depend on whether the home construction contract also meets the small contractor's test in IRC Sec. 460(e)(1)(B). (The small contractor's exemption is discussed beginning at paragraph 104.14.)[3]

104.13 **Are the Homes Speculative Homes?**

As described in Chapter 4, home construction contractors may build speculative (spec) homes, which are homes built without a sales contract and no specifically identified buyer. In this situation, no contract exists and the contractor is exempt from IRC Sec. 460. However, if a sales contract is entered into before the home is completed, a contract would then exist and should be evaluated based on the criteria in the following paragraphs.

104.14 **Home Construction Contracts That Meet the Small Contractor's Exemption**

Those home construction contracts that meet the small contractor's exemption in IRC Sec. 460(e)(1)(B) and are not speculative homes are exempt (with one exception) from both the requirements of IRC Sec. 460 and the alternative minimum tax requirements of IRC Sec. 56(a)(3). The only requirement for small home construction contractors under IRC Sec. 460 is that construction period interest must be capitalized in accordance with IRC Sec. 460(c)(3) when computing regular tax as discussed at paragraph 104.19.

104.15 **Home Construction Contracts That Do Not Meet the Small Contractor's Exemption**

The tax accounting requirements for home construction contracts that are not exempt under IRC Sec. 460(e)(1)(B) are, in general, as follows:

a. Production period interest must be capitalized in accordance with IRC Sec. 460(c)(3). (The interest allocation rules are discussed in Chapter 2.)

b. Other costs must be allocated to the contracts in accordance with the uniform capitalization rules of IRC Sec. 263A.

The accounting and cost allocation methods for home construction contracts are discussed and illustrated in Chapter 4.

Manufacturing Contracts Are Not Allowed the Small Contractor's Exemption

104.16 At this point in the flowchart in Exhibit 1-1, note that the question is again asked, “Are any of the contracts manufacturing contracts?” Also note that manufacturing contracts that are covered by IRC Sec. 460 are not allowed the small contractor's exemption in IRC Sec. 460(e). That exemption is available only for construction contracts.

Is the Small Contractor's Exemption Met?

104.17 If up to this point the contractor has proceeded down the decision flowchart in Exhibit 1-1 without qualifying for an exemption from IRC Sec. 460, there is still one remaining opportunity for an exemption. That exemption is found at IRC Sec. 460(e)(1)(B) and is referred to as the “Small Contractor's Exemption.” To qualify for the exemption, all of the following conditions must be met:

a. The contract is a construction contract [IRC Sec. 460(e)(4)].

b. At the time the construction contract is entered into, the taxpayer estimates the contract will be completed within the two-year period beginning on the contract commencement date.

c. The taxpayer's average annual gross receipts for the three taxable years preceding the taxable year in which the contract is entered into do not exceed $10 million. Reg. 1.460-3(b)(3) states that gross receipts for this purpose shall be determined based on the principles found in Reg. 1.263A-3(b). In addition to the gross receipts from all of the taxpayer's businesses, a proportionate share of construction-related gross receipts from any person owning a 5% or greater interest in the taxpayer, or in which taxpayer owns a 5% or greater interest, must also be included in the taxpayer's gross receipts. Ownership interests, including indirect ownership, are determined as of the first day of a taxpayer's tax year. Gross receipts not derived from a trade or business, such as interest income or proceeds from the sale of capital assets, are excluded.

104.18 The exemption at IRC Sec. 460(e)(1)(B) is important to small contractors because it allows them to continue their tax accounting under the old rules. This means that the cost allocation rules are not as stringent as under the newer rules. The taxpayer can use the percentage-of-completion method (PCM), the exempt PCM, the completed-contract method (CCM), the cash method [for C corporations to continue to use the cash method, an average annual gross receipts test of $5 million must be met (see paragraph 302.8)], or the accrual method. The exempt PCM allows the small contractor the flexibility to compute percentage of completion using a technique other than the cost-to-cost technique required by the newer rules. However, small contractors have not completely escaped. They must still capitalize production period interest and compute alternative minimum tax under the Tax Reform Act of 1986 (TRA '86) percentage-of-completion method. The permissible methods for exempt contractors listed in Reg. 1.460-4(c)(1) do not include the cash receipts and disbursements method. However, any permissible method allowed by Section 446 is allowable under the small contractor's exemption.

104.19 **Production Period Interest Must Be Capitalized**

While the small contractor's exemption in IRC Sec. 460(e)(1)(B) exempts the taxpayer from the primary provisions of IRC Sec. 460, it does not exempt the taxpayer from IRC Sec. 460(c)(3). The taxpayer must still allocate production period interest to long-term contracts.

104.20 **Does the Small Contractor's Exemption Apply for Purposes of Alternative Minimum Tax (AMT)?**

No, except for home construction contracts discussed at paragraph 104.12, IRC Sec. 56(a)(3) provides, in general, that the percentage-of-completion accounting method [as modified by IRC Sec. 406(b)] shall be used in determining the alternative minimum tax, even for contracts to which the provisions of IRC Sec. 460 do not otherwise apply. Accordingly, even though the contractor may be exempt from IRC Sec. 460 and able to use the completed-contract method for computing regular tax, the percentage-of-completion method as calculated under Reg. 1.460-4(b) must be used for AMT purposes.

104.21 However, small contractors that also qualify as “small corporations” are not subject to AMT. See the discussion beginning at paragraph 209.7.

104.22 **Is the Contract for Real Property?**

As indicated at paragraph 104.17, to qualify for the small contractor's exemption, the contract must be a construction contract. Also, as indicated in the definition of a construction contract at paragraph 104.4, the contract must involve real property. Real property is defined in Reg. 1.460-3(a) as meaning land, buildings, and inherently permanent structures as defined in Reg. 1.263A-8(c)(3). The term *inherently permanent structures* includes property affixed to real property that will remain affixed for an indefinite period of time, such as dams, roads, bridges, docks, parking lots, swimming pools, telecommunication facilities, pipelines, and similar structures. Nonpermanent structures such as offshore drilling rigs or vessels are not real property.

104.23 Dual-purpose Contracts.

When a contract requires the contractor to furnish land and make improvements to the land, the contract will not be classified as a construction contract if the construction activities are *de minimis*. Construction activities are considered to be *de minimis* if costs allocable to construction activities are less than 10% of the contract's total price. For this purpose, allocable contract costs attributable to construction activities do not include the cost of land provided to the customer.

Example 1-3: Dual-purpose contract.

Assume a customer and a contractor enter into a contract for the contractor to provide land and construct improvements to the land at a total contract price of $1 million. The cost of the land is $500,000 and estimated construction costs are $200,000. This contract would be considered a construction contract since total estimated costs allocable to construction activities are more than 10% of the total contract price. However, if estimated costs allocable to construction activities are only $95,000, the contract is not a construction contract and Section 460 would not apply.

Has the Taxpayer Elected to Use the Percentage-of-completion Method?

104.24 Taxpayers already using the percentage-of-completion method at February 28, 1986, or contractors that elect the percentage-of-completion method, who are not otherwise exempt from IRC Sec. 460, should be aware that the following rules also apply to them:

a. *Degree of Completion.* IRC Sec. 460 requires that the cost-to-cost method be used to determine degree of completion.

b. *Look-back Calculations.* Upon completion of a long-term contract, the taxpayer must normally “look back” and determine if there were overstatements or understatements in estimating the prior periods' tax liability for that contract. To the extent that the prior-period application of the PCM results in an over (under) statement of the tax liability, the taxpayer is due (owes) interest.

c. *Allocation and Capitalization of Costs.* IRC Sec. 460 requires, in general, that all costs that directly benefit or that are incurred because of a contract be capitalized. Costs that need not be capitalized include (a) marketing, selling, advertising, and distribution expenses; (b) Section 174 research and development expenses; (c) Section 179 costs; (d) losses under IRC Sec. 165; (e) cost recovery deductions for idle equipment and facilities; (f) income taxes; (g) strike expenses; (h) warranty and product liability costs; (i) unsuccessful bidding expenses; and (j) deductible service costs.

d. *Election to Use the 10% Method.* A contractor can postpone income recognition on long-term contracts if, at the end of the taxable year, the contracts are less than 10% complete and the contractor has elected to use the 10% method. Once made, the 10% election applies to all contracts entered into during the tax year and all subsequent tax years. The election also applies for purposes of look-back calculations and the alternative minimum tax. However, the election is not available if the simplified cost-to-cost method discussed in Chapter 2 is used.

Special 70/30 Rule for Residential Construction Contracts

104.25 For residential construction contracts, TAMRA '88 allows use of the 70/30 hybrid method. A residential construction contract is defined as follows:

A residential construction contract is similar in definition to a home construction contract (see paragraph 104.12), except that “dwelling unit” is more broadly defined as a house or apartment used to provide living accommodations in a building or structure (which may include more than four dwelling units), but does not include a unit in a hotel, motel, inn, or other establishment in which more than one-half of the units are used on a transient basis [IRC Secs. 460(e)(6)(B) and 168(e)(2)(A)(ii)].

In other words, a contract to build a hotel or motel generally would not qualify as a residential construction contract; however, a contract to build a high-rise apartment building to be occupied primarily by permanent tenants would meet the definition.

104.26 Under the 70/30 hybrid method, residential construction contracts are accounted for by the taxpayer by taking 70% of the contract into account using the PCM, and the remaining 30% of the contract is taken into account using the taxpayer's underlying method of accounting for long-term contracts. The 70/30 hybrid method is discussed in more detail beginning at paragraph 403.17.

104.27 **AMT Is Computed Using the 100% PCM**

Even though residential construction contracts are allowed the 70/30 hybrid method to compute regular tax, the 100% PCM must be used for AMT purposes.

104.28 **Taxpayers with Exempt and Nonexempt Contracts within the Same Trade or Business**

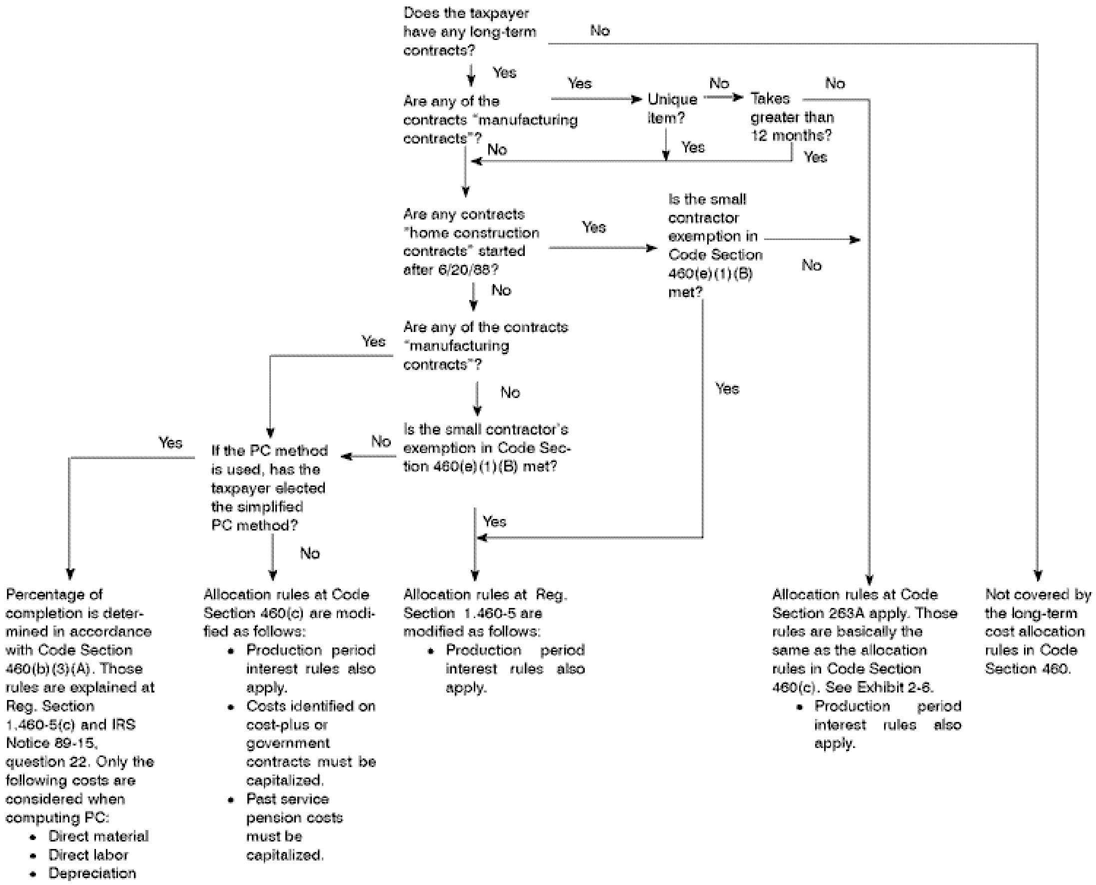
It is possible for a taxpayer to have both contracts that are exempt from IRC Sec. 460 and contracts that are not exempt from IRC Sec. 460 during the same year. (Exempt contracts include those described as being exempt beginning at paragraph 104.12 and as summarized beginning at paragraph 104.35.) Rev. Rul. 92-28 provides that a taxpayer is permitted to use different methods of accounting for the two types of contracts within the same trade or business. A taxpayer with both exempt and nonexempt contracts may use a method of accounting other than the PCM for all exempt contracts, even though the PCM must be used for all nonexempt contracts. The ruling also provides that once a taxpayer adopts a method of accounting for exempt contracts, the taxpayer must continue to use that method for all such contracts until permission is obtained from the Commissioner to change the method.

Allocation and Capitalization of Costs

104.29 The flowchart at Exhibit 1-2 has been designed to help explain the various cost allocation rules for long-term contracts. The following paragraphs coincide with decision points on that flowchart.

Exhibit 1-2

Cost Allocation Rules



104.30 **Manufacturing and Home Construction Contracts**

As previously discussed in this section and illustrated in Exhibit 1-1, certain short duration and nonunique manufacturing contracts and home construction contracts are exempt from the requirement in IRC Sec. 460 to use the percentage-of-completion method. That exemption also applies to the cost allocation rules. Home construction contracts that do not meet the small contractor exemption and manufacturing contracts are subject to the uniform capitalization rules of Code Section 263A instead of the long-term contract cost allocation rules found in IRC Sec. 460(c). However, the exemption from the long-term contract cost allocation rules may be a moot point because the Uniform Capitalization Rules in Code Section 263A are basically the same as those in IRC Sec. 460(c).

104.31 **Nonexempt Manufacturing Contracts**

As shown in Exhibit 1-2, the manufacturing contracts that are not exempt from IRC Sec. 460, either because they are greater than one year in duration or they are for the manufacture of a unique item, are subject to the cost allocation rules in IRC Sec. 460(c) instead of the uniform capitalization rules of Code Section 263A. However, this is not a major issue because the cost allocation rules of each section are basically the same [the only exception is that IRC Sec. 460(c) requires the capitalization of direct research and development costs].

104.32 **Small Contractor's Exemption**

Taxpayers with contracts that qualify for this exemption must use their normal accounting method for reporting contract costs and revenues. The normal accounting method is the method used by the taxpayer immediately prior to March 1, 1986, such as the exempt percentage-of-completion, completed-contract, cash, or an accrual basis method. Exempt small contractors are not subject to the cost allocation rules of 460(c), but instead must use the cost allocation rules in Reg. 1.460-5 for contracts entered into on or after January 11, 2001, or prior Reg. 1.451-3(c)(5) for contracts entered into before January 11, 2001, plus the capitalization of production period interest required by IRC Sec. 460(c)(3).

104.33 **PCM Taxpayers**

Taxpayers not exempt under the small contractor's exemption of IRC Sec. 460(e) are subject to the cost allocation rules in IRC Sec. 460(c).

104.34 **Simplified Cost-to-cost Method**

As shown in Exhibit 1-2, the percentage-of-completion taxpayers can elect the “simplified cost-to-cost” method, which is authorized by IRC Sec. 460(b)(3)(A). The application of the simplified cost-to-cost method, which is discussed in Chapter 2, is explained in Reg. 1.460-5(c) and IRS Notice 89-15.

Summary of IRC Sec. 460

104.35 To summarize the guidance of IRC Sec. 460, the following rules apply:

a. Construction contracts that are less than two years in duration and performed by contractors who have average annual gross revenues less than $10 million for the three-year period preceding the commencement of a contract are exempt from IRC Sec. 460. Those contracts can be accounted for using the old cost allocation rules and an exempt accounting method to compute regular tax. However, production period interest must be capitalized and the percentage-of-completion method must be used to compute alternative minimum tax.

b. Most manufacturing contracts are exempt from the long-term contract rules if they are expected to be completed in 12 months or are not for the manufacture of a unique item. Those manufacturing contracts that do not meet the length or uniqueness tests must be accounted for using the PCM under IRC Sec. 460. However, AMT must be computed on those contracts using the 100% PCM. The small contractor's exemption is not available for manufacturing contracts.

c. Home construction contracts are generally exempt from IRC Sec. 460. However, the following rules apply to such contracts:

(1) Production period interest must be capitalized.

(2) If the small contractor's exemption in IRC Sec. 460(e)(1)(B) is met, the home construction contracts are exempt from the requirement to use the PCM when calculating AMT and from the uniform capitalization rules in IRC Sec. 263A.

(3) Contractors that do not qualify for the small contractor's exemption must apply the uniform capitalization rules in IRC Sec. 263A. In addition, the PCM is not required for AMT purposes.

d. The 70/30 percentage of completion-capitalized cost method (PCCCM) can be used for residential construction contracts. However, AMT for those contracts must be calculated using the PCM. (See paragraphs beginning at 403.17 for a discussion of the PCCCM.)

e. All other long-term contracts are subject to IRC Sec. 460 and generally must be accounted for using the PCM.

104.36 **Is Avoiding the Percentage-of-completion Method Beneficial?**

The answer to that question depends on the unique circumstances of each taxpayer, but may be stated in general terms as follows:

a. If the taxpayer qualifies as a small contractor in accordance with IRC Sec. 460(e)(1)(B), avoidance of the PCM will generally be justified by the cash flow savings generated by the tax deferral from the completed-contract method (provided that the alternative minimum tax does not impact this deferral). However, those taxpayers must anticipate higher CPA consulting and tax preparation fees because:

(1) AMT must be computed on the 100% PCM, and conversion to PCM (even using the allowed simplified cost-to-cost method discussed in Chapter 2) may be time consuming.

(2) For financial statement purposes, the taxpayer will, in most cases, be required to use the PCM. Therefore, workpaper conversion to the completed-contract method (or other method) may be required to compute regular tax. Also, when financial statements are presented on the PCM and the tax return is prepared on another method, the deferred tax accounting is more complex.

b. If the taxpayer does not qualify for the small contractor exemption, the PCM must generally be used. Large residential construction contractors using the 70/30 PCCCM may find it easier to justify avoiding the election of the PCM.

c. If the taxpayer satisfies the definition of a “small corporation” the company is exempt from AMT.

104.37 **How to Change to the Percentage-of-completion Method**

If the taxpayer decides to change to the percentage-of-completion method, the procedures in Rev. Proc. 97-27, including later modifications and amplifications, and the guidance in IRS Notice 89-15 should be followed. Rev. Proc. 97-27 simplified the procedures for requesting a change. The taxpayer should also consider the pros and cons of electing the simplified cost-to-cost method to compute the percentage of completion, including the disallowance of the 10% method if the simplified method is used. The simplified cost-to-cost method is discussed in Chapter 2. Additionally, certain changes from the cash method of accounting or from an exempt method of accounting to the percentage-of-completion method of accounting are allowed automatically under Rev. Proc. 2011-14 (which amplifies, clarifies, modifies, and in part supersedes Rev. Procs. 2008-52 and 2009-39). Automatic changes in accounting provisions are discussed in section 709.

Checklist to Assist in Applying IRC Sec. 460

104.38 Appendix 1A contains a checklist that is designed to assist the construction contractor or accountant in applying IRC Sec. 460. This checklist should be completed for any taxpayer that has a contract for the manufacture, building, installation, or construction of property that has not been completed at the taxpayer's year end.

Recently Issued Tax Laws Affecting Contractors

104.39 **Middle Class Tax Relief and Job Creation Act of 2012**

Signed on February 22, 2012, this law extended the 2% reduction in the employee share of the Medicare tax through the end of 2012, without the limitations in the Temporary Payroll Tax Cut Continuation Act of 2011.

104.40 **Temporary Payroll Tax Cut Continuation Act of 2011**

This law, signed on December 23, 2011, extended the 2% cut for the employee share of Medicare to the end of 2012, with some limitations (subsequently eliminated by the Middle Class Tax Relief and Job Creation Act discussed at paragraph 104.39).

104.41 **3% Withholding Repeal and Job Creation Act of 2011**

This law, signed on November 21, 2011, repealed the 3% withholding required on certain payments made to vendors by government entities. Withholding was to be required beginning on January 1, 2012. This law also expanded the Returning Heroes and Wounded Warriors Tax Credit under IRC Sec. 51.

104.42 **Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010**

The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (Tax Relief Act) was signed into law on December 17, 2010. There were a number of provisions of the Tax Relief Act that could apply to contractors, including the following:

• Extension and increase of bonus depreciation.

• Extension of 15-year depreciation for real estate.

• Reduction of the payroll tax rate by 2% through 2011, which was later extended through 2012 (see paragraph 104.39).

The provisions of the Tax Relief Act are discussed where applicable throughout the *Guide*.

104.43 **Small Business Jobs Act of 2010**

The Small Business Jobs Act of 2010 (Jobs Act) was signed into law on July 27, 2010. There were a number of provisions of the Jobs Act that could apply to contractors, including the following:

- Extension of bonus depreciation.
- Extension and increase of enhanced Section 179 deduction extended for one year.
- Expansion of Section 179 property to certain qualified real estate.
- Extension of 15-year depreciation for real estate.
- Exclusion of bonus depreciation from costs under the percentage-of-completion contract method (i.e., depreciation is “de-coupled”) for assets with life of seven years or less that are placed in service after December 31, 2009 and before January 1, 2011.
- Shortening of holding period to five years for built-in gains when converting from a C corporation to an S corporation beginning in 2011.
- Increase in the exclusion from 75% to 100% of gain on sale of small-business stock acquired after September 27, 2010 and before January 1, 2012, and held for at least five years.
- For eligible small businesses (annual gross receipts less than $50 million), an increase to five years for the carryback of general business credits (which are not subject to alternative minimum tax), effective for credits determined in the taxpayer's first taxable year beginning after December 31, 2009.

The provisions of the Jobs Act are discussed where applicable throughout the *Guide*.

104.44 **Patient Protection and Affordable Care Act**

The Patient Protection and Affordable Care Act (Health Care Act), signed into law in March 2010, includes a number of provisions that will apply to contractors. The provisions of the Health Care Act take effect in different years: 2010, 2011, 2012, 2013, 2014, and 2018. The particulars of the Health Care Act are beyond the scope of this *Guide*, but contractors should be aware of this Act and its implications.

104.45 **Hiring Incentives to Restore Employment Act**

The Hiring Incentives to Restore Employment Act (HIRE Act) was signed in March 2010. One provision of the HIRE Act that applies to contractors is an extension of enhanced small business expensing for machinery and equipment (Section 179 deduction). See the discussion on the Section 179 deduction beginning at paragraph 703.20.

104.46 **Worker, Homeownership, and Business Assistance Act of 2009**

The most significant item for contractors in the Worker, Homeownership, and Business Assistance Act of 2009 was the provision allowing for a five-year carryback of net operating losses (NOLs). Under this provision, a contractor that has an NOL for a tax year beginning or ending in either 2008 or 2009 can elect to carry back the NOL for three, four, or five years (the normal carryback period is two years). If the five-year period is elected, the contractor can only offset up to 50% of income in the fifth year back with an NOL carryback (see Example 1-4). The American Recovery and Reinvestment Act of 2009 (discussed beginning at paragraph 104.47) expanded the NOL carryback period only for eligible small businesses, but the Worker, Homeownership, and Business Assistance Act of 2009 removes this limitation; thus, the longer NOL carryback period is available to all businesses.

Example 1-4: Limitation on five-year NOL carryback.

A contractor has a $500,000 loss in year 20X9. This contractor had income in years 20X4 through 20X8, respectively, as follows: $400,000, $200,000, $300,000, $500,000, $100,000. Since the contractor has income in 20X4, a five-year carryback of the NOL is elected.

Due to the 50% limitation, only $200,000 of the NOL ($400,000 income in 20X4 × 50%) can be used in 20X4; $200,000 would be used in 20X5, and $100,000 would be used in 20X6.

The IRS issued IRS Notice 2010-58 (in a question and answer format) to provide guidance addressing issues that have arisen related to the carryback of NOLs.

104.47 **American Recovery and Reinvestment Act of 2009**

The American Recovery and Reinvestment Act of 2009 (ARRA) included several tax law changes aimed to help small businesses survive the current uncertain economic times. In fact, one provision of ARRA allowed small businesses with losses to improve cash flow by recouping up to five years of taxes. One of the most important changes for the construction industry was the provision that lengthened the amount of time that a net operating loss (NOL) could be carried back by small businesses [4] for tax year 2008 from two to five years. Because many contractors and construction companies experienced significant slowdowns and losses during 2006 and 2007, the lengthened time to carry back losses allowed contractors and construction companies to carry back losses to years previously closed to carrybacks. In many cases, the taxpayer had substantial income and taxes in those years.

104.48 Under the ARRA, a business that repurchases in 2009 and 2010 its own debt for less than the outstanding amount (which generally is discharge of indebtedness income) may pay the taxes on cancellation of debt income over a five-year period, beginning with 2014. (See the discussion on cancellation of debt by an S corporation beginning at paragraph 602.30.)

104.49 Finally, the ARRA also includes a three-year extension of the production tax credit (PTC) for electricity derived from wind (through 2012) and for electricity derived from biomass, geothermal, hydropower, landfill gas, waste-to-energy, and marine facilities (through 2013). (See the discussion on credit for federal tax on fuels beginning at paragraph 504.19.)

104.50 **Energy and Highway Tax Acts of 2005**

The Energy and Highway Tax Acts of 2005 included some provisions that could be favorable to contractors. For example, certain contractors may benefit from the energy efficient commercial property deduction (discussed further at paragraph 703.24) or the homebuilder's credit for construction of new energy-efficient homes (discussed further in section 408).

104.51 The energy efficient commercial property deduction allows a deduction of up to $1.80 per square foot for costs associated with energy efficient commercial building property, and contractors who build new homes that meet energy efficient standards are eligible for a tax credit of up to $1,000 or $2,000 per dwelling unit, depending on energy efficiency.

104.52 **American Jobs Creation Act of 2004.**

Another deduction that contractors may benefit from is the domestic production activities deduction that was created in the American Jobs Creation Act of 2004. Contractors are considered a manufacturer for this purpose and may be entitled to a credit for domestic production activities. Details of this law are discussed in section 711.

104.53 **Circular 230**

The IRS response to the abusive tax shelters that have been marketed by some of the national CPA firms and others has been to tighten up on opinions on tax issues written by CPAs and attorneys. Unfortunately, the IRS reaction is a broad-brush approach and covers almost all tax advice given by advisors. In accordance with Treasury Circular 230 (the rules governing practice before the IRS), if a client asks for a written opinion on a tax issue, the tax advisor has to either write an opinion that covers all potential problems, or must "legend out" (discussed in the following paragraph) so that the client cannot rely on the opinion to avoid any penalties that the IRS may impose. This covers *all tax correspondence*, even emails.

104.54 The "legend out" language will be somewhat like the following: "Please be advised that, based on current IRS rules and standards, the advice contained herein is not intended to be used, nor can it be used, for the avoidance of any tax penalty that the IRS should assess related to this matter."

104.55 As might be expected, the accounting and legal communities are in an uproar over the IRS reaction and this procedure may change in the future. However, these procedures are still in effect as of now and must be followed. In fact, the IRS issued final regulations on May 31, 2011 that extend the previous regulations that applied to attorneys, certified public accountants, enrolled agents, and other specified tax professionals to all tax return preparers, including currently unenrolled tax return preparers. Under these regulations, all paid tax return preparers must register by obtaining a preparer tax identification number (PTIN) and passing a tax compliance and suitability check. Preparers who are not federally authorized tax practitioners must also pass a competency examination and fulfill continuing education requirements.

104.56 Circular 230 can be found at **www.irs.gov/pub/irs-pdf/pcir230.pdf**. The August 2011 revision incorporates changes to the rules of practice regarding the new registered tax return preparer designation described at paragraph 104.55. Other provisions affect all practitioners. For example, under revised Section 10.34(a), practitioners cannot sign a tax return or claim for refund with a position (or advise a client to take a position) that (a) lacks a reasonable basis; (b) is an unreasonable position under IRC Sec. 6694(a)(2); or (c) is due to willful or reckless conduct under IRC Sec. 6694(b)(2). Furthermore, tax practitioners now have a mandated responsibility to inform their clients of any potential penalties related to positions they have advised or noted in a return they have signed, as well as any opportunities to remedy these issues via additional disclosure. In addition, Circular 230 has expanded the phrase *disreputable conduct* to include willfully failing to file a tax return electronically when required to do so (unless due to reasonable cause and not willful neglect), and willfully preparing all or substantially all of a tax return or claim for refund without a valid Preparer Tax Identification Number (PTIN.) Revised Section 10.36(b) requires management with principal authority and responsibility for overseeing a firm's tax return practice to take reasonable steps to ensure there are adequate procedures in place for complying with Circular 230.

104.57 IRS Ann. 2011-24 provides that if an attorney, certified public accountant, enrolled agent, or other person subject to the Circular 230 regulations governing practice before the IRS (practitioner) is found to have violated those regulations, the practitioner can be disbarred or suspended, which means the practitioner is permanently or temporarily ineligible to represent taxpayers before the IRS. Monetary penalties can be imposed on the practitioner or the practitioner's employer, firm, or entity if it knew, or reasonably should have known, of the misconduct.

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[2] A long-term contract method of accounting is only available to taxpayers that have long-term contracts, as defined in Reg. 1.460-1(b)(1). The IRS has published several revenue rulings (70-67, 80-18, and 82-134) holding that an architect, an engineer, and a taxpayer providing engineering and construction management services cannot use the completed-contract method of accounting for income tax purposes. The IRS has also held, in Rev. Rul. 84-32, that a painting contractor that paints industrial and commercial buildings, railroad bridges, and industrial plants is not entitled to use the completed-contract method for income tax purposes.

[3] In August 2008, the IRS issued proposed regulations relating to home construction contracts that expand the types of contracts eligible for the home construction exemption. The term *home construction* is expanded to include contracts for the construction of any dwelling unit. For example, a land developer who sells individual lots (and the developer's contractors and subcontractors) may be deemed to have long-term construction contracts that qualify for the home construction contract exemption. Additionally, the proposed regulations expand the definition of *townhouse* to include individual condominium units and allow each condominium unit to be treated as a separate building for purposes of determining whether the underlying contract qualifies as home construction. However, until the regulations are made final, taxpayers may not change or use a method of accounting based on the proposed regulations. These proposed regulations are discussed in more detail in Chapter 4.

[4] Small businesses are defined in accordance with IRC Sec. 448(c). In general, a business qualifies as a small business if gross receipts average less than $15 million per year for the last three years ending in the year prior to the loss. A small business can be a partnership, corporation, or sole proprietorship.

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105 Special-purpose Entities (SPEs)

105.1 The accounting profession has responded to the various entities established to hide or at least camouflage debt or losses by issuing several pronouncements dealing with the presentation of special-purpose entities in a company's financial statements. Taxation has not been as affected, except for the investigation by the IRS of the use of special-purpose entities as tax shelters or in creating fictitious losses. These investigations have led to the subpoena of the records of certain international CPA firms and the requirement that the list of clients that had been sold specific tax shelters be made available to the IRS for investigation.

105.2 For other business reasons, contractors still have the need to form special-purpose entities. These reasons include estate tax planning, employee benefits, and bonding capacity. Entities that continue to be formed include joint ventures formed between a contractor and a guarantor. The contractor needs the financial strength provided by the guarantor, even though the guarantor will not provide any direct resources related to the performance on a construction contract.

105.3 Real estate will generally be held in a separate entity from the construction operations to limit the financial exposure and possibly for estate planning purposes, as well. An equipment company as a special-purpose entity continues to provide segregation of specific assets. It can also be utilized by a construction company owner to provide tax sheltered cash flow benefits for employees, while allowing the employees to build equity which can later be used to help acquire the contractor's equity in the construction company.

105.4 Although they continue to lose financial reporting benefits, special-purpose entities will always have a home in the construction industry for providing contractors and their key employees the ability to share tax attributes.

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106 Construction Industry Trends

106.1 The home surplus continues to decrease, and home prices in some areas are responding with increasing values, while other heavily devastated parts of the country continue to suffer due to their local economies. The effect of the surplus on the economy has decreased as home contractors have started building out smaller projects. Additional construction has been seen in multi-family residential projects (i.e., apartments), as rental inventories have decreased significantly. As a result, there has been overall growth in the construction industry, although at a low rate. This has helped to moderate the previous impact of the economy. Other parts of the construction industry, such as commercial, industrial, and manufacturing construction, are experiencing growth in contracts and contract revenues. Bid prices seem to have stabilized; however, the contractor is being faced with ongoing material price increases. Office building construction continues to be inconsistent throughout the country, as vacancy rates and over supply continue to impact many markets.

106.2 Due to funding issues, the slowdown in publicly financed construction continues to concern contractors. This situation has resulted in a fewer number of contracts, each with a higher dollar value. Also, lenders continue to reduce their exposure to real estate loans and project owners are relying more on their own cash reserves.

106.3 Additional funding questions continue with the shortfall projected in the Highway Trust Fund. [The Highway Trust Fund (HTF) was created by the Highway Revenue Act of 1956 (Pub. L. 84-627), primarily to ensure a dependable source of financing for the National System of Interstate and Defense Highways and also as the source of funding for the remainder of the Federal-aid Highway Program.] Legislation for a long-term comprehensive solution remains stymied. Even short-term reauthorization appears to be in jeopardy.

106.4 In recent years, tax preparers for the small contractor have had to plan and advise their clients about the tax implications of deferred income from contracts completed and reported currently for tax purposes, but from which there is no current cash flow, since profits and cash were most likely collected in a previous year. Small contractors are experiencing an increased backlog of work in progress, which is helping to ease cash flow issues related to the payment of taxes on completed projects.

106.5 Cash flow continues to haunt many contractors as developers, private construction owners, and government agencies have appeared to slow down the payment process, and as contract disputes grow in frequency and dollar amount. Stimulus spending is also reaching a conclusion.

106.6 Also, planning the timing of deductions to offset income at the maximum tax rates paid by the contractor over several years will take on a more prominent role than income reporting policies. This planning now requires further analysis in projecting the tax benefit provided by the Section 199 deduction and the potential loss of some of this benefit when losses are carried back to prior years. (See the discussion of the Section 199 deduction at section 711.) In addition, deferring income to future periods requires a guess as to whether the tax rates will be higher or lower in the subsequent years as political turmoil continues on this issue in federal and state capitols.

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107 Current Issues Being Challenged by the IRS

107.1 This section discusses several issues the IRS currently is focusing on during its examinations. Some of these “hot” topics are specific to construction contractors, while others could affect taxpayers in all industries.

General

107.2 The IRS continues to address key issues relating to the definition of home construction contracts, income recognition policies, and look-back compliance. In May 2009, the IRS issued a revised *Construction Industry Audit Technique Guide* (see discussion at paragraph 100.9) that includes discussions on all of these topics. Annually in the fall, the IRS issues a Priority Guidance Plan, which contains a list of projects on which the IRS is working and hopes to complete during their year ended June 30. They also issue updates to this plan during the year. The most recent plan was issued on September 2, 2011 for the 2011-2012 year, and the most recent update was issued April 27, 2012. Included in the plan is “Regulations under Section 460 regarding home construction contracts.” Proposed regulations expanding the types of contracts that qualify as home construction contracts were released August 1, 2008. The proposed regulations will offer the construction contractor more flexibility in applying the definition of a “home construction contract.” When the home construction market re-energizes, the final regulations will likely have been issued providing a cash flow benefit to the home construction contractor. The proposed regulations will be effective for tax years beginning on or after the date they are finalized, and taxpayers may not rely on the proposed rules until after regulations are finalized and published. These proposed regulations are discussed in more detail in Chapter 4.

Look-back

107.3 In May 2009, the IRS issued its revised *Construction Industry Audit Technique Guide* (ATG). The ATG is intended to be both an in-depth guide for tax examiners conducting audits in the construction industry and an information tool for taxpayers and practitioners associated with the construction industry. Chapter 5 of this ATG deals with look-back, including how the examiners will calculate the various figures used and what common mistakes examiners should look for. The ATG can be found on the IRS website at **www.irs.gov**. The Priority Guidance Plan referred to in paragraph 107.2 also contains a section on look-back. Included in the IRS plan is “Regulations under Section 460 addressing the application of the look-back interest rules to certain pass-through entities with tax-exempt owners.” IRS examinations of look-back and common look-back errors are discussed further in section 210.

Methods of Accounting

107.4 The IRS continues to look at methods of accounting, including the use of an improper method of accounting for long-term contracts; failure to use the percentage-of-completion method of accounting when required to do so by IRC Sec. 460; deduction of contingencies, warranties, and guarantees; inclusion of contingencies, warranties, and guarantees in the percentage-of-completion computation; and failure to capitalize construction period interest.

Tax Shelters

107.5 The IRS has been vigorously attacking schemes that create large capital losses through a series of partnerships and S corporations. Recently, when a business owner sells a business and has a large capital gain, some large CPA firms have been marketing a scheme that would create capital losses to offset the gain. Typically, these schemes have been very expensive, and the clients have to pay a large fee up front to receive information on the plan. Since the schemes are now under audit, some clients are suing the CPA firms. A number of these lawsuits have been publicized in *The Wall Street Journal*.

107.6 It has become standard IRS tax examination procedure for taxpayers to sign off on a “tax shelter: listed transactions” letter to confirm and disclose certain practices that are considered illegal schemes. Such schemes include prohibited transactions in the areas of health and fringe benefits, minimum funding standards in employee stock ownership plans, deductibility of contributions to employee benefit plans, life insurance contracts for executives and other highly compensated employees, etc.

107.7 As part of its crackdown on tax shelters, the IRS requires Form 8886 (Reportable Transaction Disclosure Statement) to be filed for a large number of transactions. The types of transactions that are “reportable” can be found on the IRS website at **www.irs.gov/Businesses/Corporations/Abusive-Tax-Shelters-and-Transactions**.

Stock Transferred as Compensation

107.8 The Court of Federal Appeals for the Federal Circuit reversed the holding of the Court of Federal Claims that, in cases of deductions for employers that use property transfers other than money to compensate employees, the amount of the employer's deduction under IRC Sec. 83(h) is limited to the value of the transferred property actually included in the employee's gross income. Consequently, the sole shareholders of an S corporation were entitled to deduct the value of restricted stock transferred to the corporation's chief operating officer as compensation under IRC Sec. 83(h), without regard to the amount actually included in the officer's return as income [*Robinson v. U.S.* (92 AFTR 2d 2003-5349, July 15, 2003)].

Offshore Compliance Program

107.9 The IRS continues to aggressively search offshore (i.e., non-U.S.) for unreported income. For example, in 2009, the IRS and the Department of Labor announced an agreement with the Union Bank of Switzerland (UBS) that resulted in the IRS receiving an unprecedented amount of information on United States holders of accounts at UBS. The IRS continues to fine and prosecute individuals from the list who did not report income on their U.S. income tax returns, and/or individuals who did not file a Foreign Bank Account Report. The IRS continues to operate an Offshore Voluntary Disclosure Program. The most recent program was announced in January 2012; details can be found on the IRS website at **www.irs.gov/uac/2012-Offshore-Voluntary-Disclosure-Program**.

Limited Issue Focused Examination Program

107.10 The IRS's Limited Issue Focused Examination (LIFE) Program applies the best audit practices that the IRS has used through the years around the country in an attempt to expedite the audit process. The LIFE audit techniques apply to corporations and partnerships having assets of over $10 million. Small businesses and partnerships having assets of $10 million or less are handled by the IRS Small Business Self-Employed (SBSE) Division.

Section 460 and Retainages Payable

107.11 The IRS examination division position on whether to include the retainage payable in the cumulative allocable contract costs actually incurred on a year-by-year basis has been that it has to be examined in conjunction with Section 461 and the all events test. The IRS position that retainages payable are included in contract costs to date had the effect of increasing the percentage of completion, and thus revenue, each year. The Coordinated Issue Paper on retainages has been decoordinated and IRS examiners are no longer directed to follow this position.

107.12 If a contractor changes its method of accounting for retainages from a method where all retainages are included in costs to a method where retainages are excluded from costs to date until the retainage is paid, this is considered a change in accounting method and a Form 3115 must be filed. The wording in the contracts between the contractor and the subcontractors must support the deferral.

Writedown of Real Estate "Inventory" to Market

107.13 Due to the declining values of real estate, many developers have been considering whether they can write down the value of their "inventory" to the lower of cost or market. Although this is a valid tax planning idea for traditional inventory, real estate is not inventory under either IRC Sec. 471 or Sec. 263A, and, therefore, cannot be written down. This position has consistently been upheld by the courts and is aggressively monitored by the IRS.

Research and Development Credit

107.14 More contractors have found that they qualified for the federal research and development (R&D) credit under IRC Sec. 41. The provision to elect an R&D credit under IRC Sec. 41 expired December 31, 2011. In many cases, contractors are finding that they qualified in prior years; thus, amended returns are being prepared and submitted. The IRS has also increased the number of R&D credit claims it has been auditing. See paragraphs beginning at 504.29 for further discussion on the research and development credit.

Per Diem

107.15 The IRS is still attacking per diem and what percentage is made up of meals. In a Tax Court case [*Boyd et al. v. Comm.* (122 TC 305, April 27, 2004)], the entire per diem allowance was attributable to meals. Although this case involved long-haul truckers (who used motels only occasionally), the case points out that there must be an accountable plan and that lodging expenses must either be paid directly or be reimbursed under the accountable plan to be deductible. (See further discussion on the per diem method of substantiation beginning at paragraph 503.15.)

107.16 The IRS has also issued guidance (Rev. Rul. 2006-56) indicating that all payments made under an expense allowance arrangement that has no mechanism or process to track allowances paid and routinely pays per diem allowances in excess of federal per diem rates without requiring actual substantiation of all expenses or repayment of any excess amount, will be treated as made under a nonaccountable plan. (See further discussion on excess per diem allowances beginning at paragraph 503.34.)

107.17 In addition, the IRS has issued guidance (Rev. Proc. 2004-29) on the use of statistical sampling to establish the amount of the taxpayer's substantial expenses paid or incurred for meals and entertainment that are *not* subject to the 50% limitation on deductibility.

Accumulated Earnings

107.18 Although the accumulated earnings issue was more of a problem prior to 2003, the IRS is still raising this issue on occasion. (See discussion on accumulated earnings at section 707.) The IRS is trying to apply the “Bardahl” formula (discussed at paragraph 707.5) to contractors, and that is very difficult [*Bardahl Manufacturing Corp.*, TC Memo 1965-200 (1965)].

107.19 If a C corporation's balance sheet shows a lot of cash and short-term investments and there are no plans for expansion, the IRS may take a look at the accumulated earnings tax. It may be a good idea for the contractor to consider converting to S corporation status or to distribute dividends, especially while the 15% tax rate on dividends is still in effect. (The 15% rate expires after 2012—see paragraph 107.23.)

107.20 In a 9th Circuit case [*Metro Leasing* (94 AFTR 2d 2004-5251, July 23, 2004)], the 9th Circuit ruled that a contested tax deficiency that was paid before the issue was resolved in the court is *not* deductible in arriving at accumulated taxable income.

107.21 This decision created a split between the 9th and 5th Circuits. The 5th Circuit has held that a contested tax liability paid before the legal contest is resolved is deductible in arriving at accumulated taxable income.

107.22 In *Otto Candies, LLC v. U.S.* (91 AFTR 2d 2003-2520, May 28, 2003), two related limited liability corporations were not liable for accumulated earnings tax because the Tax Court conducted a three-part analysis and concluded that the amounts accumulated reasonably anticipated business needs. The first step in the analysis was to determine business needs. Reasonable needs included both present day-to-day operating needs (also referred to as working capital) and anticipated future needs. In the second step, the amounts were compared to the corporation's available funds to meet the needs identified in step one. The final step deemed the excess distributable and subject to accumulated earnings tax. The Tax Court also declined to follow the 5th Circuit case regarding the reduction for paid but contested income tax liability.

107.23 In any event, to mitigate or avoid the issue altogether, corporations have until December 31, 2012 (as extended by the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010) to take advantage of the 15% penalty tax on improper accumulations by distributing dividends.

S Corporation Returns

107.24 Subchapter S corporations have been under increased scrutiny by the Internal Revenue Service in recent years, resulting in more audits.

107.25 The IRS will sort out information from these audits to analyze how compliant companies are with the tax law and to decide whether any changes are needed in tax policy or the Internal Revenue Code.

107.26 An S corporation must distribute cash in proportion to the ownership. The IRS thinks that owners are not following these rules and are trying to allocate income under the rules pertaining to partnerships. Other areas the IRS is focusing on include the long-term contract adjustment for alternative minimum tax and the reasonableness of compensation paid to S corporation owners, especially in cases where the IRS feels that not enough compensation is being paid, and the S corporation has made distributions of earnings. Taxpayers and practitioners should review their small S corporation tax returns for compliance with those rules.

107.27 S corporations and partnerships with total assets per their financial statements of $10 million or more are required to complete the Schedule M-3 reconciling financial statement income to tax return income. Schedule M-3 is designed as a tool to aid IRS auditors to focus on high-risk issues.

Trust Returns

107.28 Another area that may see increased IRS scrutiny is trust returns (Form 1041). As part of its examinations of federal estate tax returns, the IRS has instructed its estate tax examiners to also look at the related fiduciary income tax returns, especially the tax returns of trusts created by the estate under examination.

Partnership Returns

107.29 The IRS successfully attacked Family Limited Partnerships (FLPs) in *Strangi* (96 AFTR 2d 2005-5230, August 8, 2005). However FLPs are not dead; if structured properly, FLPs are still a good tool for eliminating assets from a taxable estate.

107.30 Many businesses are now operating as limited liability corporations (LLCs), which are typically taxed as partnerships for federal income tax purposes. The earnings of a member who is considered a managing member of the LLC will be considered as earnings from self-employment. Whether a member meets the definition of a managing member is open to interpretation and has been an area on which the IRS has focused in recent years.

Individual Returns

107.31 The IRS has plans to audit many more individual returns. To help with this task they have hired new field agents across the country. These auditors are very inexperienced; therefore, expect a lot of unagreed cases.

Uncertain Tax Positions

107.32 FASB ASC 740-10 requires companies to recognize in their financial statements tax positions taken in income tax returns that have a tax benefit with a greater-than-50% likelihood of being realized upon settlement. In connection with the issuance of accounting guidance related to uncertain tax positions (UTPs), the IRS launched an “Initiative to Expedite Resolution of Uncertain Tax Positions Prior to Adoption of FIN 48” (Initiative). As a follow up to this Initiative and in keeping with the IRS's continued focus on transparency, the IRS in September 2010 released a new tax return schedule, Schedule UTP with instructions. Beginning with the 2010 tax year, applicable taxpayers (see paragraph 209.26) will have to disclose and include with their income tax returns information on uncertain tax positions. (Uncertain tax positions are further discussed at section 712.)

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108 Construction-related Associations

108.1 Construction associations offer many potential benefits to internal accountants and practitioners. For internal accountants, associations may provide information, such as key industry statistics and comparative financial data, for analyzing company performance and identifying areas for improvement. Associations may also provide networking opportunities with other internal accountants and other professionals serving the construction industry. These networking opportunities allow accountants to discuss: (a) common tax accounting and reporting issues, (b) current trends in the construction industry, and (c) service providers such as sureties, attorneys, accountants, and insurance carriers.

108.2 Associations can also benefit practitioners by providing: (a) a target audience for marketing tax and other services, (b) access to key industry statistics for analytical procedures and consulting services, and, (c) an opportunity to become involved in the industry.

108.3 Some of the national associations both industry and public accountants may want to consider joining include:

American Institute of Architects
(202) 626-7300 or (800) 242-3837
www.aia.org

American Subcontractors Association
(703) 684-3450
www.asaonline.com

Associated General Contractors of America
(800) 242-1767
www.agc.org

Associated Builders and Contractors, Inc.
(703) 812-2000
www.abc.org

Building Owners and Managers
Association International
(202) 408-2662
www.boma.org

Construction Financial Management Association
(609) 452-8000
www.cfma.org

Society of Industrial and Office Realtors
(202) 449-8200
www.sior.com

Construction Industry CPAs Consultants Association
(480) 836-0300
www.cicpac.com

Construction Millennials of America
www.constructionmillennials.com

Design-Build Institute of America
(866) 692-0110
dbia.org

American Road and Transportation
Builders Association
(202)289-4434
ARTBA.org

National Utility Contractors Association
(703)358-9300
www.NUCA.com

A listing of other national, regional, and local construction-related associations is available at **www.4specs.com/s/assoc.html**. In addition, a listing of subcontractor-related associations is presented in Appendix 5A.

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