

Chairman, ABC National Tax Advisory Group
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ABC Meets With IRS to Address Recent IRS Policy Decisions That Increase Tax for Subcontractors

Under recent IRS policy, two subcontractors could be taxed differently even though they are performing substantially the same type of work. Consider two paving contractors who are delivered blue prints and an invitation to bid on two new home developments. The first subcontractor is going to submit a bid and be contracting with a home-builder who will, like the subcontractor, be on-site performing construction services. The second subcontractor is submitting a bid to a general contractor hired by a land developer who performs no work on the site.

At a public forum in early December 2005, the IRS indicated that they are considering a policy that will allow them to tax these two subcontractors differently based on who is the owner of the property - a homebuilder or a land developer. This disturbing news comes after the IRS has been narrowing their interpretation of what is 'home construction' for a 'Home Construction Contract' (HCC). For example, over the last few years the IRS has been taking the position that only certain work in the proximity of the home and lot qualified under the definition of home construction. This is very different from prior guidance the IRS had issued. .

The result is that fewer subcontractors will be able to use more favorable

revenue recognition methods such as the Completed Contract Method for these types of jobs. They will incur more taxable income earlier than should be required. This issue clearly affects many ABC members who may work on residential projects where they perform infrastructure, paving, site development, concrete and other construction services.

On December 14, 2005, I represented ABC along with Carin Nersesian, Director of Government Affairs for ABC, in a meeting with the Internal Revenue Service in Washington, DC. The IRS is reviewing this issue as part of the Service's Industry Issue Resolution (IIR) Program. Earlier this year ABC filed a request, as did the Construction Financial Management Association (CFMA), that the IRS consider this issue.

The IIR Program is an IRS process to address frequently disputed and burdensome tax issues that affect a significant number of business taxpayers through the issuance of published legal and/or administrative guidance. The issue of HCCs submitted by ABC and CFMA was one of only two issues selected for the IIR program in the IRS's recent cycle.

The initial IIR meeting functioned as an opportunity for the industry representatives to explain the industry's understanding of the issues and to assist the IRS to better understand industry practices.

It was a real concern for industry representatives to learn just before this initial IIR meeting that the IRS intended to treat two similarly situated subcontractors performing identical construction services differently solely because of the structure of the property owner. Representatives for the Construction Industry expressed concern about the resulting administrative burden on subcontractors having to inquire as to how property owners are structured merely as prerequisite of determining how the specific contract is to be reported for tax purposes. The contractor representatives at the meeting made the point that the focus must be on the nature of the work performed and not based on ancillary information that may be difficult for a subcontractor to acquire.

It was clear from the discussion that the Internal Revenue Service is interested in getting to common ground. At the same time, the IRS needs to know that their concerns about perceived abuses of the current rules are addressed and resolved. The IIR process has a guideline of nine months for achieving certain results, which may include: recommending legislative or regulatory changes, issuance of a revenue ruling, or no new guidance being issued.

It will be interesting to see what transpires from this unique IIR process.

Rich Shavell, CPA, CCFP is President of Shavell & Company, P.A. CPAs and Consultants in Boca Raton and Stuart, FL. Rich has been an advocate for contractors over the last twenty years presenting comments before the IRS on proposed regulations and testifying before the House and Senate on behalf of ABC. Currently, Rich serves as Chair of ABC's National Tax Advisory Group. Locally he serves on our Chapter's Legislative Committee and Rich is the 2005 winner of the South FL Business Journal's Excellence in Accounting Award in Construction. For more information visit www.shavell.net or call (561) 997-7242.