

Witnesses Argue for Change to Effective Date Of New Home Construction Contract Rules (December 8, 2008)
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Witnesses Argue for Change to Effective Date Of New Home Construction Contract Rules

The Internal Revenue Service still has to clarify some issues surrounding proposed rules (REG-120844-07) concerning home construction contracts, such as the effective date of the rules when finalized, tax accounting method changes, and high-rise condominiums, Rich Shavell of Associated Builders and Contractors Inc. said at a Dec. 5 IRS hearing on the rules.

The proposed regulations, issued Aug. 1, would expand the types of contracts that qualify for the home construction contract exemption and modify the rules for taxpayer-initiated changes in accounting methods to comply with tax code Section 460 regulations (149 DTR G-1, 8/4/08).

ABC is concerned about the timing of the effective date of the rules, which would apply to the tax year the year after finalization, Shavell said. "There are folks that really need that help right now," he said.

With the expansion of the definition of a town house and row house to include a condominium unit, allowing condominium developers the option to take advantage of the changes provided by the rules would be good for them, given the current economic situation, Shavell said.

"We don't view this as a significant change," Shavell said. "We view this as a definitional clarification." Therefore, ABC does not see why the expansion should not be available for all open tax years, he said.

Howard Levine, partner at Roberts & Holland, Washington, D.C., also testified about the effective date provision in the proposed rules. Given the language of this provision in the proposed rules, they would not apply until 2010 at the earliest, Levine said. IRS should provide that the rules are applicable to all open years in the final regulations, but this will not be enough for condominium developers since finalization will not happen for a while, he said.

As a solution, IRS should immediately issue a notice or a revenue procedure stating that taxpayers can rely on the proposed regulations and use the methods prescribed by them, or that they can use other methods that are approved under current law, Levine said. IRS has previously issued notices and other guidance when proposed rules were pending in several situations, he said, so there is a precedent.

"Not one of them is as compelling as this situation, especially as applied to condominium developers,"

Levine said.

Both large and small developers “are struggling to stay alive,” and this is something that should be done to help them, Levine said.

Shavell Asks for Transitional Relief

IRS should confirm that taxpayer-initiated changes in accounting method will be given the timing and treatment consistent with current rules that allow a four-year spread for positive changes and the deduction of the entire negative tax code Section 481(a) adjustment in the initial year of change, Shavell said. The final rules also should provide transitional relief so taxpayers can opt to use the cutoff method where it used to be available in the old rules, he said.

Shavell said ABC maintains that the transition rules should address the effective date of the proposed regulations.

“The current financial crisis dictates that immediate transition relief be provided so that taxpayers are afforded the opportunity to take advantage of the regulations’ definitional clarifications for all open tax years,” he said.

Severing, Completion Rules

The sale of units or lots is not a workable alternative for contractors, Shavell said in reference to IRS’s request for comment on severing and completion rules. Contractors and subcontractors do not know or cannot easily learn when units or lots are closed and transferred to buyers.

“Requiring contractors to obtain this information would be extremely burdensome and, in some cases, costly,” he said.

The preamble to the rules suggests an alternative—that the trigger for determining the timing for severing the contract on a dwelling unit or lot can be based on when the taxpayer is paid under the contract, Shavell said. ABC thinks such a trigger would prevent the contractor from receiving the benefits Congress intended for home construction, he said.

“We don’t see how this new trigger for reporting would lead to better, clearer reflection of income than the currently available reporting bases,” Shavell said. He said ABC urges IRS to not pursue this direction.

Any changes to the severing rules should only apply to HCCs, Shavell said. ABC members continue to seek an increase in the inflation index of the Section 460(e) threshold, he said, which is currently \$10 million. ABC is concerned that any new rules put into place targeting tax accounting methods beyond the clarification related to HCCs will impact a large segment of the commercial construction industry with bad economic consequences, he said.

“An objective review of the commercial construction industry will demonstrate that there has not been a need to mandate the use of the percentage -of-completion methodology,” Shavell said.

High-Rise Condominiums an Issue

IRS still needs to clarify issues surrounding high-rise condominiums, Shavell said. Shavell gave some examples to illustrate where questions remain, such as:

- A subcontractor, such as an electrical subcontractor, has a contract covering an entire high-rise condominium construction project, including common areas, he said. He asked if ABC would be correct to assume that the entire contract would be an HCC, provided there were no commercial components.
- ABC would consider a roofing contractor working on the construction of a high-rise

condominium work under an HCC, Shavell said. He asked if a roofer replacing a roof after initial construction would still qualify. He also asked if work would qualify as done under an HCC if the top floor of a building contained condominium units while the remaining floors contained commercial operations.

ABC believes the final regulations need to provide clarifications and examples of what would and would not qualify in the case of high-rise condominiums, Shavell said.

By Lauren Gardner

A transcript of the hearing  is in TaxCore.

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