



Major Victory for ABC: IRS reverses position affecting contractors

On August 1, 2008 IRS issued Proposed Regulations that effectively reverse a position IRS took that was negatively impacting contractors and subcontractors. This was accomplished as a result of ABC working with IRS on this and other contractor tax issues.

Recall from prior columns (March/April 2006) that in 2005 ABC requested IRS reconsider their position, which they started to narrow, as to which contractors could use the completed contract method for home construction contracts. The IRS was busy making policy statements and definitional changes that would prevent subcontractors from using more favorable reporting methods for certain contracts. ABC met with IRS and has been working on this issue since 2005 through the IRS Industry Issue Resolution Program.

The basic concern is that two subcontractors would 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 contract with a homebuilder 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.

The IRS, in a Directive issued to its field auditors in early 2007 stated that these two subcontractors would be taxed differently based on who is the owner of the property – a homebuilder or a land developer. Of course, this begs the question of how would the subcontractor even know how the owner of the property is structured and what work that owner self-performs.

The result was that fewer subcontractors could 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 work on residential projects where they perform infrastruc-

ture, paving, site development, concrete and other construction services.

The Proposed Regulations clarify some of these issues reflecting that a land developer selling individual lots – and its contractors and subcontractors – could have long-term construction contracts that qualify for the home construction contract exception. This clarification is

a reversal of one of the positions the IRS took in its 2007 Industry Director Directive. While, the IRS position in the 2007 Industry Director Directive will remain in force until the Proposed Regulations are finalized, these Proposed Regulations do reflect current IRS sentiment.

There is still much to be done. As part of these Proposed Regulations the IRS is asking for feedback on additional technical issues surrounding the completed contract method, which would impact contractors beyond those working on home construction.

With residential construction at a virtual standstill one may question if this issue is still a concern. Since the IRS typically audits a year or two after the filing of a tax return, this may be of concern to those who are just now getting audit

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notices that impact years when residential construction was elevated. Moreover, the 2007 Industry Director Directive (see column in May/June 2007 issue) states that this is a mandatory audit issue. That means if the taxpayer is using the more favorable completed contract method of accounting the auditor has no choice but to examine the issue.

Since the early 1990s ABC has worked hard to open the lines of communications with the IRS to voice the views of our members and how IRS regulations and policies affect our members' wallets. In this case we utilized the IRS Industry Issue Resolution Program to convey a clear message: the IRS was changing positions and narrowing definitions that had been in place and well understood since the late '80s. We told IRS we did not think this was proper and that it would negatively impact our subcontractor members. This is a major victory for ABC and the construction industry. It is not often that the IRS reverses positions, but this is clearly what happened here.

There is still much to be done. As part of these Proposed Regulations the IRS is asking for feedback on additional technical issues surrounding the completed contract method, which would impact contractors beyond those working on home construction. A hearing will be held in November 2008 at which time ABC will again get an opportunity to share its views with the IRS. ■



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