

## *Down economy is a good time for contractors to rethink tax strategy*

The construction industry has been hit as hard as any by the recession. Many small construction companies have ceased to exist while others have dramatically downsized to survive.



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One of the few financial bright spots for construction companies is that the recession offers some a rare opportunity to take advantage of tax-saving opportunities.

In an attempt to help small businesses, Congress passed the American Recovery and Reinvestment Act of 2009, commonly known as the stimulus package. A provision in the law enabled small businesses with a net operating loss in 2008 to elect to offset

this loss against income earned in up to five prior years. To qualify, a small business had to have no greater than an average of \$15 million in gross receipts over a three-year period ending with the tax year of the net operating loss.

This change allowed many construction companies to recoup prior tax bills and generate an influx of cash to help survive the recession in 2009. So what happened? For many, this cash is gone and most construction companies are still in a survival mode, where cash flow is critical.

Deferring paying taxes is almost as good as receiving a refund. A change in how a small construction company accounts for its long-term contracts can provide such an opportunity, resulting in improved cash flow.

A contractor normally has at least two methods of accounting, an overall method and one or more methods for long-term contracts on projects not completed in the taxable year it was signed.

Internal Revenue Code Section 460 generally

requires a taxpayer to determine the income from a long-term contract using the "percentage-of-completion method." This method requires including in income the portion of the contract price that corresponds to the percentage of the contract completed during the taxable year.

IRC Section 460(e) provides two exceptions for requiring the use of the percentage-of-completion method for long-term contracts: home construction contracts and the "small contractor exception."

To meet the small contractor exception, two requirements must be satisfied. First, when the contract was entered into, it must have included an estimate that it would be completed within a two-year period beginning on the commencement date of the contract. Second, the contractor's average annual gross receipts for the three taxable years preceding the year in which the contract was entered into did not exceed \$10 million.

If a construction company meets the small contractor exception, then the completed-contract method may be used, with no income reported until a contract is complete.

Utilizing the small-contractor exception and the completed-contract method means taking into consideration the alternative minimum tax (AMT). When calculating AMT, the percentage-of-completion method must be used when accounting for long-term contracts. Corporations with average annual gross receipts of \$5 million or less qualify for exemption from AMT. After the first year, the corporation will continue to qualify as long as average gross receipts do not exceed \$7.5 million.

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