Tax Planning Opportunities for the Construction Industry

Accounting method changes for large contractors

Description of change	How contractors can benefit	Action items	Timing	Other considerations
Adoption of new revenue recognition standards (ASC 606)	Application of revenue recognition standards for GAAP, may slow or accelerate revenue for reporting purposes, depending on when taxpayer recognizes revenue under new performance obligation model set forth in new standards.	Goes into effect for calendar year 2019, but important to identify during 2018 process, potential impact areas for GAAP reporting and its impact for tax.	Any automatic change can be made in the taxpayer's first, second or third taxable year ending on or before May 10, 2021.	Outside of the current three-year window noted under 'timing', advance consent with the IRS would be required pending further guidance.
Impact of Section 451(b) on book-tax conformity	New rule under TCJA, mandates certain accrual-method taxpayers shall recognize gross income for tax purposes no later than taken into account in a taxpayer's applicable financial statement.	This binds closely with new ASC 606 standards above, as it's important to understand potential GAAP differences and/or upcoming changes to GAAP revenue reporting. Even if not electing to follow ASC 606 for tax purposes, 451(b) may require following similar concepts for consistency with financial statement reporting.	No need to file a Form 3115 if any required change (under new tax) is made immediately in the first taxable year after December 31, 2017.	Applies only if accrual method and have a required applicable financial statement (AFS). For closely held contractor clients, this would normally mean an audited financial statement. The new rules do not apply to any specific items of gross income where a special method of accounting is used (i.e. Sec. 460).
Impact of Section 451(c) on advance payments	New rule under TCJA mandates accrual-method taxpayer must include advance payments in income when received, unless elected to defer for tax purposes to the first year only following receipt.	Identify if taxpayer receives advance payments, and determine if any current inconsistencies between GAAP and tax reporting, and if the deferral on those payments exceeds 12 months.	No need to file a Form 3115 if any required change (under new tax law) is made immediately in the first taxable year after December 31, 2017.	This section largely tracks existing Revenue Procedure 2004-34, which allowed the deferral of advance payments in a similar manner pre tax reform.

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Accounting methods available to large contractors (over $25 million in average annual gross receipts) have not changed:

Description of change	How contractors can benefit	Action items	Timing	Other considerations
Percentage of Completion Method (PCM)	In general, taxable income from a long-term contract is determined under PCM.	If contractor moves from a defined small contractor to a large contractor due to revenue growth, no formal election or method change needed. Apply PCM to the contracts started in the first year of application.	Incorporate into an entity tax return, including extensions.	Large contractors will typically be required to apply PCM to long-term contracts. As noted under action steps, if contractor moves between large and small under the definition of the $25M, further considerations should be given.
Percentage of Completion - 10% Method	Defer recognition of revenue under PCM until 10% of estimated total contract costs are incurred and allocated.	Election attached to tax return in the year adopting.	File with entity tax return, including extensions.	Unavailable if the taxpayer elected to utilize the simplified cost-to-cost method for PCM, versus standard "cost-to-cost" method.
Percentage of Completion - Capitalized Cost Method (PCCM)	Ability for those contractors with residential construction contractors to report 70% of the contract under PCM, and the remaining 30% under exempt method (e.g. - completed contract).	Requires advance consent of the IRS by filing Form 3115.	Filed by the last day of applicable tax year.	Definition of residential contract in this regard means building with 4 or more units versus home construction contract which is 4 or fewer. Further definitions are key to review under IRC Section 460(e).

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Accounting methods available to large contractors (over $25 million in average annual gross receipts) have not changed:

Description of change	How contractors can benefit	Action items	Timing	Other considerations
Accrual excluding retainages	Defer inclusion in income of retainages withheld by customer until final acceptance by customer occurred as specified in the contract. Contract must be exempt from IRC Section 460 (short-term).	Requires automatic consent of the IRS by filing Form 3115.	File with entity tax return, including extensions.	Must also exclude retainage payable related to same short-term contracts.
Accrual excluding retainage payable	Retainage payable related to long-term contracts are not included in contracts costs until the retainage is payable to the subcontractor as defined in the contract. This slows the percent complete and reduces income recognition.	Requires advance consent of the IRS by filing Form 3115.	Filed by the last day of applicable tax year.	Contract language is key is applicability.

Tax Planning Opportunities for the Construction Industry

Accounting method changes for smaller contractors

Description of change	Which contractors may benefit	Action steps	Timing	Other considerations
Accounting for Long Term Contracts: TCJA increased the exemption for requirements to use the percentage completion method of accounting for long term contracts for taxpayers with less than $10 million in average annual gross receipts to less than $25 million in average annual gross receipts.	Contractors with revenues less than $25 million currently using the % completion method	Completion and submission of Form 3115 under automatic change provisions	By due date of the return including extensions	Conversion applied on the cut-off method for contracts entered into after December 31, 2017
Other methods available:				Application may be made concurrent with other changes available under TCJA provisions
Completed contract: Revenues and costs for each contract is deferred until the job is at least 95% complete				For non C-corporation entities - beware of AMT issues on taxable income difference between method and percent complete income
Cash: Revenues are and costs are recognized when collect/paid.				
Accrual: Revenues recorded as available to be billed, Costs recorded based on economic performance occurs.				

Tax Planning Opportunities for the Construction Industry

Accounting method changes for smaller contractors (continued)

Description of change	Which contractors may benefit	Action steps	Timing	Other considerations
Overall method change from accrual to cash method: TCJA increased the gross receipts threshold for the requirement to use the accrual method of accounting from $5 million to $25 million.	Contractors with revenues less than $25 million currently on the accrual method	Completion & submission of Form 3115 under automatic change provisions	By due date of the return including extensions	Conversion made through 481(a) adjustment determined at beginning of the year of change with negative adjustment applied in the year of change and positive adjustment taken into account ratably over 4 years
Accounting for Inventories: TCJA no longer requires accrual method of accounting if company revenues are less than $25 million; inventory is non-incidental material and supplies or accounting treatment is consistent with applicable financial statement				