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Completed Contract Method Permitted for Grading and Soil Compaction

CONSTRUCTION, INTERNAL REVENUE SERVICE
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In Technical Advice Memorandum (TAM) 201650014, the IRS has determined that long term contracts requiring grading and soil compaction qualify for the completed contract method of accounting. The completed contract method allows taxpayers to defer revenue and gross profits on long-term contracts until the completion of the contract.

Under IRC §460, taxpayers with long-term construction contracts are generally required to use the percentage-of-completion method of accounting. The percentage-of-completion method recognizes revenues and gross profits as a percentage of the work completed during the year. While this method provides accurate income measurement, it could also lead to paying tax on income that has not yet been received.

An exception to the general rule is the use of the completed contract method for a home construction contract. A contract qualifies as a home construction contract under §460(e)(6)(A) if 80% or more of the total contract costs are attributable to construction activities for buildings containing four or fewer dwelling units and improvements to real property directly related to and located on the site of those units. These contracts required the taxpayer to perform grading and soil compaction of the pad area for the construction of the homes.

The IRS determined that the grading and soil compaction of the pad area are necessary for the foundation of the houses and should be considered as a portion of the dwelling units. In addition, the replacement of a house and its foundation would require destruction of the pad, so the cost of the pad would be included in the cost basis of the house.

For additional information regarding TAM 201650014, or methods of accounting for construction companies, [contact us](#).

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