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**Atlanta Athens**

**Construction Dollars and Sense**

**Tax and Financial Reporting**

**News and Tools July 2021**

**The IRS has not recently focused on contractors** but some things point to a coming change. A decade ago, an IRS official, when asked why contractors were not being audited, replied, “There is no money there.” The money is there now with construction booming, and the IRS wants to be sure they get their share..

**Briefly:**

→It appears that the IRS may be again starting to focus on audits of the construction industry. They have updated their audit guide for contractors.

**The Treasury has announced** that they want to hire more agents for more audits. The conversations in Washington include more money to the IRS for more examining agents. Perhaps the strongest indicator that things may be changing is the update in April of the IRS’ *Construction Industry Audit Technique Guide*, which was last updated more than a decade ago. The 175 page document is the handbook for training agents about the rules, laws, and things to look for when auditing a contractor.

**The current ATG** is much more readable than the prior version and omitted about 100 pages of outdated example square foot costs of materials and labor. Such example costs were misleading to an examining agent if the contractor had costs that varied from the outdated published lists. The agent may then expect, in error, the contractor to have doctored its records and overstated costs to reduce taxes. A remnant of those standard costs still exist in the current version which states that a 2,000 square foot home may require 13,127 board feet of framing lumber, 15 windows, 12 exterior doors, etc. If the contractor being examined had costs for 20 windows in a house that size, it could cause the agent to wrongfully expect fraudulent diversion of materials and / or underreported income.

**The ATG is a great**  primer for the inexperienced IRS agent or the construction financial manager. It describes different types of contracts, bonding, financial reporting, and some of the complexities of the tax law, regulations, and contractor cases. But it is very misleading in many instances. For example, it states that when a contractor sends an invoice to a customer the credit goes to an account named ‘Costs and Estimated Earnings in Excess of Billings” which is the procedure for absolutely no contractor. Of course, the credit goes to Revenue and the over or under billings are adjusted later for financial reporting. The ATG also stated that the overbilling and the underbilling accounts “…should be present on the balance sheet.” Maybe not, if the contractor does not have over or underbillings at the end of the year. Such misguided instruction, which is numerous in the ATG, can cause unnecessary conflict in the IRS examination.

The ATG even gives an incorrect cite of the Internal Revenue Code on page 46 as 460((e)(1)(B) which should in fact be 460(e)(1)(A). This will likely not be noticed by too many agents or contractor financial managers, but there are many instances of this type of error in the Guide.

**The newly updated ATG**  should be required reading for the construction financial manager not only to be aware of what the IRS may be looking for in an exam, but also to serve as a refresher of the rules and regulations, many of which may provide tax saving opportunities to the contractor.

Questions or comments? Contact Al Clark at 404-252-2208 or AClark@SmithAdcock.com.

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