

Construction Dollars and Sense

**Tax and Financial Reporting
News and Tools**

August 2018

Briefly:

→The new tax law allows some great accounting method changes. For large contractors, a new change in method for computing the PCM is huge!

The Tax Cuts and Jobs Act

(TCJA) generally effective starting in 2018, raised the threshold for the requirement to use the percentage-of-completion method (PCM) from \$10million average annual gross receipts (AAGR) to \$25million for contracts starting in 2018.

Contractors who were previously required to switch from a deferral method, such as the completed contract method (CCM), because their AAGR exceeded \$10million, or the cash or an accrual method, will be able to go back to that former method in 2018 if their AAGR is less than \$25million. The required steps are in an IRS issued Revenue Procedure dated August 3, 2018.

Contractors using, or going back to, an accrual method, can elect to exclude retainage receivable from revenue as late as the date for filing the tax return. This election requires that retainage payable also be deferred until it is actually payable, but since the receivables generally are more than the payables, the net difference is a great deferral to a subsequent year.

A huge benefit is available for contractors using the PCM in certain common situations. This is not a provision of the TCJA, but a calculation that the IRS has only recently been approving for the last few months. This change in accounting method requires the prior consent of the IRS.

Revenue for the PCM is calculated with a ratio using the costs incurred in the numerator and total estimated costs in the denominator. The more costs that are incurred, the more taxable revenue will be reported. Cost deferral for contracts in progress defers revenue and thus defers and/or saves taxes.

Contractors have long been deferring income by excluding retainage payable to subs from the numerator, but now the IRS is allowing, as a change in a tax accounting method, the full exclusion of the entire subcontractor payable for contracts which are “pay-if-paid” with the subcontractor. If the contractor has not been paid by its customer for the work of the subcontractor, then with those pay-if-paid subcontracts, the entire payable to the sub does not meet the tax definition of a cost and can be excluded from the numerator in the calculation of the PCM. The change in method is not an automatic change, it requires the prior consent of the IRS, and it requires a very detailed submission of numerous specific forms, documents, calculations, explanations, and information. The requested change will likely not be approved by the IRS unless it is submitted precisely in accordance with all the extensive rules and regulations for the calculation of the PCM, the tax definition of costs, the enforceable payment laws of the states in which the contractor operates, the requirements of the applicable forms, the several IRS regulations for requesting the change, the legal determination of the payment requirements, etc. If the change request is not approved by the IRS, the contractor has to wait 5 years to try again. But if the requested change is approved, the tax savings can be huge.

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

The information herein is general in nature and should not be construed as advice or opinion of Smith, Adcock and Company LLP.

It should not be used as a substitute for competent advice which should be obtained from your Smith Adcock professional.