WHICH METHOD OF ACCOUNTING IS RIGHT FOR LAND DEVELOPERS?

By Ryan Paluso, CPA

Selecting the right accounting method for your land development business is an important step in laying the foundation for a profitable future. Land developers have three methods of accounting to choose from. It is important to understand the tax implications of each one before deciding which method works best for you.

Completed Contract Method (CCM)

In CCM, the taxpayer reports the income and expenses only after the contract is complete, regardless of whether cash receipts were received prior to completion. As for all methods, there are some benefits and disadvantages to CCM. If a contract is in progress at the end of the year, this method allows the taxpayer to defer the revenue and not pay tax until the following year. On the other hand, if a taxpayer has a handful of projects that end around the same time, this will cause a dramatic increase in revenue and expenses. From a third party perspective, this can make the taxpayers business look inconsistent. The CCM is limited to home construction contracts and small contractors with contracts not exceeding two years.

Percentage-of-Completion Method (POC)

In contrast to CCM, the POC method recognizes income and expenses over the life of the contract. Income and expenses for each period are calculated by taking the percentage of current costs incurred over total estimated costs for the contract. That calculated percentage is multiplied by the estimated total income and expenses for the contract to determine the tax liability for the year. For this method to work correctly, you need to be able to reasonably estimate the remaining costs to complete a contract. In theory, this method should provide more accurate and consistent accounting numbers.

Percentage of Completion Capitalized Cost Method (PCCM)

The PCCM is limited to residential construction. As opposed to home construction, buildings with four or fewer dwelling units, residential construction comprises of buildings with five or more dwelling units. Examples of residential construction include apartments, condominiums, nursing homes and prisons. Hotels and motels do not qualify as residential construction. PCCM allows the taxpayer to use a combination of the CCM and POC. Under PCCM 30% of the contract is under the CCM and 70% is under the POC method. The advantage of the PCCM is the taxpayer gets an additional deferral thanks to 30% of the contract accounted for under the CCM. Beware, there is an AMT adjustment as AMT requires the entire contract to be reported under the POC method.

If you have any questions regarding which method of accounting you should use for your business, reach out to your CPA. This will ensure you are making the right choice and benefiting your business for the future.

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