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Tax Court - Methods of accounting for land development contracts

June 2: The U.S. Tax Court today issued an opinion finding that the taxpayers' bulk sale and custom lot contracts were long-term construction contracts for which the taxpayers may use a permissible method of accounting for long-term contracts, such as the percentage of completion method. However, the Tax Court found that neither these contracts, nor other contracts were home construction contracts (as defined by section 460(e)) and that, as such, the taxpayer could not account for these contracts using the completed contract method of accounting. *Howard Hughes Co. LLC v. Commissioner*, 142 T.C. No. 20 (June 2, 2014).

Read the 66-page [opinion](#) [PDF 217 KB]

Background

The taxpayer companies were engaged in residential land development near Las Vegas, Nevada, and sold land to builders and, in some instances, to individuals who construct and sell houses. The taxpayers generally sold land through bulk sales, pad sales, finished lot sales, and custom lot sales.

- In the bulk sales, the taxpayers developed raw land into villages and sold an entire village to a builder. The taxpayer did not otherwise develop the sold village.
- In pad sales, the taxpayers developed villages into parcels and sold the parcels to builders. Again, the taxpayer did not develop within the sold parcels.
- In finished lot sales, the taxpayers developed parcels into lots and sold whole parcels of finished lots to builders.
- In custom lot sales, the taxpayers sold individual lots to individual purchasers or custom home builders, who then constructed the homes.

In all instances, the taxpayers did not construct residential dwelling units on the land they sell. However, the taxpayers did construct infrastructure and common improvements related to these land sales.

During the years at issue, the taxpayers reported income from purchase and sale agreements under the completed contract method of accounting. The IRS, however, challenged this treatment and asserted that the contracts were not home construction contracts within the meaning of section 460(e) and that the land sale contracts were not long-term construction contracts and thus were not eligible for the long-term percentage of completion method of accounting under section 460.

Tax Court's findings

The Tax Court held that the taxpayers' bulk sale and custom lot contracts were long-term construction contracts for which the taxpayers, if those contracts were entered into in a year before their completion, may use a permissible method of accounting for long-term contracts, such as the percentage of completion method.

The court held that the subject matter of the contracts encompassed more than just the sale of the lot, so that final completion and acceptance did not necessarily occur at the close of escrow, but rather occurred when final completion and acceptance of the subject matter of the contracts—which include improvements whose costs are allocable to the bulk sale or custom lot contract, occurs. This is consistent with the court's February 2014 holding in [Shea Homes, Inc.](#) [PDF 259 KB].

However, the Tax Court found that none of the land development contracts was a home construction contract and that the taxpayers may not report gain and loss from these contracts using the completed contract method of accounting. As the court stated in its opinion today, and to distinguish from its earlier opinion in *Shea Homes*:

Our Opinion today draws a bright line. A taxpayer's contract can qualify as a home construction contract only if the taxpayer builds, constructs, reconstructs, rehabilitates, or installs integral components to dwelling units or real property improvements directly related to and located on the site of such dwelling units. It is not enough for the taxpayer to merely pave the road leading to the home, though that may be necessary to the ultimate sale and use of a home.

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