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Ninth Circuit: Builder's completed contract method of accounting, housing development amenities are included

The U.S. Court of Appeals for the Ninth Circuit today affirmed a decision of the U.S. Tax Court that taxpayers-builders in consolidated cases were entitled to use the completed contract method of accounting under section 460 for reporting income and loss from the sales of housing development projects.

The Ninth Circuit concluded that the Tax Court did not clearly err in determining that the home sale contracts included certain development amenities and were not, as asserted by the IRS, limited simply to the house and the lot on which the house sat. *Shea Homes, Inc. v. Commissioner*, No. 14-72161 (9th Cir. August 24, 2016)

Read the Ninth Circuit's [decision](#) [PDF 118 KB] that includes a separate concurring opinion.

Background

The taxpayers (both a corporation and related partnerships) develop large, planned residential communities in California and the southwest United States. The taxpayers develop the land and construct homes and common improvements, including amenities.

For the years at issue, the taxpayers reported income from their contracts for the sale of homes using the completed contract method of accounting.

- Under the taxpayers' interpretation of this method of accounting, their contracts were completed when they meet the use and 95% test under Reg. section 1.460-1(c)(3)(A) and incurred 95% of the costs of the development.
- Also, the taxpayers contended that "final completion and acceptance" under Reg. section 1.460-1(c)(3)(B) did not occur until the last road was paved and the final bond was released.

The IRS disagreed, and instead contended that under the completed contract method, the subject matter of the contracts consisted only of the houses and the lots upon which the houses were built. According to the IRS, the contract for each home satisfied the final completion and acceptance test when there was closure of escrow for the sale of each home. The IRS also countered that contracts entered into and closed within the same tax year were not long-term contracts under section 460.

The Tax Court, in its 2014 opinion, agreed with the taxpayers that the subject matter of the contracts consisted of the home and the larger development—including amenities and other common improvements. Accordingly, the Tax Court concluded that the taxpayers were allowed to report income and losses from sales of homes in their planned developments using their interpretation of the completed contract method of accounting.

Ninth Circuit

The Ninth Circuit today affirmed, finding that the Tax Court did not clearly err in its determination, with the appeals court noting that until the taxpayers' work was complete, they had an obligation to fulfill their promises regarding the development that they had induced the buyers to become a part of. As noted in the appellate court's decision, the Tax Court had found that the subject matter of the contracts between the buyers and the taxpayers encompassed more than mere "bricks and sticks" of the homes, and that the buyers were purchasing "the entire lifestyle of the development" fostered by the carrying out of the promises regarding what the development would be and with the taxpayers incurring related costs and obligations.

The Ninth Circuit also affirmed that the taxpayers had used a permissible method of accounting that clearly reflected their income.

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