TAX ACCOUNTING METHOD CHANGE CASE STUDY

CLIENT OVERVIEW

Our client is a construction company that specializes in building infrastructure, and has annual revenues of approximately $50 million. They were incorporated in 1969 and operated as a C Corporation until 2007, when they elected to be taxed as an S Corporation.

THE SITUATION

In 2008, the client was having a very profitable year, so as part of our tax planning for that year, we recommended that they change their accounting method for income tax purposes to reduce the tax liability for 2008. For income tax purposes, the client had been using the percentage of completion method of accounting for both long-term and short-term contracts.

THE SOLUTION

With the client's approval, we elected to change their method of accounting for income tax purposes from the percentage of completion method to the cash method of accounting for all jobs that did not fall under the requirement that long-term contracts be accounted for under the percentage of completion method.

This accounting method change allowed the client to defer recognition of $3.8 million in taxable income for that first tax year under the cash method. This resulted in approximately $1.5 million of taxes deferred. While the amount of the deferral fluctuates each year based on the client's contract mix, four years later, the client still has a significant deferral of income.

TAX SAVINGS

2008 Deferred Income	$ 3,800,000
Federal and state tax rate	40%
Tax deferred to future years	$ 1,520,000

This deferral of taxes has allowed cash to remain in the client's business which would otherwise have been used to pay taxes. The client has utilized this cash to purchase equipment and make other strategic decisions in order to grow and acquire larger contracts.

Warren Averett
CPAs AND ADVISORS