United States Senate

WASHINGTON, DC 20510

March 9, 2016

The Honorable Jacob J. Lew
Secretary of the Treasury
U.S. Department of the Treasury
1500 Pennsylvania Ave., NW
Washington, DC 20220

Dear Secretary Lew:

As the Treasury Department finalizes new tax guidance on accounting methods for home construction contracts, we urge you to provide taxpayers with meaningful relief from existing rules that unjustly accelerate the tax liability on condominium construction. Left unchanged, the rules threaten new housing production, job growth, and economic activity.

Large construction projects, such as major condominium developments, regularly take two or three years to complete, or even longer. In these cases, the developer will often market units to the public prior to completion and accept deposits from prospective buyers in order to secure construction financing. During the construction period, the developer does not receive "draws" or "progress payments". The developer does not receive the balance of the purchase price or access to the original deposit until the condominium unit is delivered and the buyer closes. State law and contractual commitments typically restrict the developer's access to deposits, and until the transaction is completed and the buyer takes possession, there is no certainty that the developer will receive the proceeds from the sale.

Under current law, developers of condominium buildings with five or more units are required to use the percentage-of-completion method of accounting for federal tax purposes. The percentage-of-completion method requires the developer to recognize income and pay tax on the expected profit as construction is ongoing, well before a sale closes and full payment is due. The rule creates a mismatch of cash flow and tax liability, precisely the problem that the home construction exception in section 460(e) was intended to address.

In order to pay tax on this income, developers must have other revenue streams, or they must secure financing or capital from another source. This limits the amount of capital developers have to fund projects. Financial institutions will not finance tax payments through construction financing because tax payments are not considered a cost of the project. Failure to find the additional financing or capital needed to prepay tax on the income threatens a taxpayer's ability to follow through with construction projects that strong underlying economic fundamentals would otherwise justify. In short, the current rule creates artificial hurdles to high-density condominium construction, distorts the economics of residential construction, and appears to serve no tax policy purpose.

Fortunately, the Treasury Department can solve this problem and provide a lift to the economy in forthcoming section 460 regulations regarding home construction contracts. The new regulations could incorporate the change proposed by the last Administration in REG-120844-07 (Sept. 29, 2008) and expand what is considered a townhouse or rowhouse, for purposes of the home construction contract exemption, to include an individual condominium unit. Alternatively, pursuant to its grant of regulatory authority under section 460(h), Treasury could provide for an exclusion from the percentage-of-completion method if a condominium buyer puts up a deposit of 20 percent or less, not counting amounts outside the control of the developer (whether escrowed by state law or otherwise). Either of these options would allow high-density condominium developments to qualify for the completed contract method of accounting, which more accurately matches cash flow and tax liability.

The U.S. construction industry lost 2.3 million jobs between April 2006 and January 2011. While construction employment has increased, our economy has added fewer than one million construction jobs since hitting bottom. From architects and engineers to tradesmen, sales agents, and building operators, condominium construction puts people of all skill levels to work in well-paid positions. Eliminating unfair taxes on the income of new condominium construction would help ensure that projects move forward and put more Americans back to work.

For these reasons, we encourage you to use the regulatory process to ensure that new condominium development, like other residential construction, qualifies for the completed contract method of accounting. If you would like to discuss this matter further, please do not hesitate to contact Monica McGuire in the Office of Senator Johnny Isakson at (202) 224-3643, or Beth Bell in the Office of Senator Ben Cardin at (202) 224-4524.

Sincerely,

Senator Johnny Isakson

Senator Benjamin L. Cardin

Senator Michael F. Bennet

Senator Robert P. Casey, Jr.

Senator Dean Heller

Senator Robert Menendez

Senator Bill Nelson

Senator Rob Portman

Charles Schumer

Senator Charles E. Schumer

Mark R Warner

Senator Mark R. Warner