

# **SPECIAL** Report



NATIONAL ROOFING CONTRACTORS ASSOCIATION

## **NEW IRS RULES CONCERNING THE CASH METHOD OF ACCOUNTING**

The Internal Revenue Service has advised us that it has taken several significant actions regarding the issue of when a business can use the cash method of accounting.

Previously, the IRS has argued that employers such as roofing contractors were in the business of providing merchandise, and, therefore, had to use inventory accounts and an accrual method of accounting.

In a letter addressed to NRCA, Joseph G. Kehoe, Commissioner of the IRS's Small Business/Self-Employed Division says: "We recognize that it is a burden for small businesses to use inventory accounts and an accrual method and we have taken several significant actions to reduce that burden."

Those actions include two that are important to roofing contractors:

First, the IRS published a revenue procedure that permits taxpayers that have average annual gross receipts of \$1 million or less to use the cash method of accounting. This includes taxpayers "that provide goods in connection with their services."

Second, pending the issuance of future guidance, the IRS Chief Counsel issued a notice that says the IRS "will not assert that taxpayers that provide goods in connection with services are providing merchandise and, therefore, must use inventory accounts and an accrual method of accounting. For example, this would apply to taxpayers such as paving, painting, roofing, drywall, or landscaping contractors."

Please note, however, that the Chief Counsel's notice goes on to say that this new policy "does not apply to taxpayers that are resellers, manufacturers, or otherwise required by section 448 to use an accrual method of accounting – e.g., a C corporation with gross receipts of \$5 million or more." We are seeking a clarification from the IRS as to whether this policy would apply, for example, to a subchapter S corporation with gross receipts in excess of \$5 million, as it would appear.

The IRS has also recommended that a project intended to resolve this issue be placed on the Service's Priority Guidance Plan for publication this year.

We urge our members to consult with their accountants and tax advisors concerning these changes. A copy of the letter we received from the IRS is enclosed for your information; copies of the relevant documentation are available to any member on request.