

Construction Dollars and Sense

Tax and Financial Reporting
 News and Tools

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Briefly:

→The tax law requires the percentage of completion method for long-term contracts, but residential contracts have a special exception.

The PCM, the percentage of completion method of reporting income for tax purposes, is required by tax law for long-term contracts. There are exceptions to the rule and the exceptions can provide great tax deferrals. The exceptions were expanded by the One Big Beautiful Bill Act, (OBBBA) signed into law in July.

A small contractor is exempt from the use of the PCM. The size of the contractor, to fit this exemption, is based on the average annual gross receipts of the contractor for the prior three years. This threshold is \$31 million for 2025 and \$32 million for 2026. Contractors who fit this exemption can use other methods, such as the cash method, an accrual method, or the completed-contract method.

Home construction contracts have been exempt since the rules for Code Section 460 became effective almost 40 years ago. The home construction contract was defined as a contract for buildings that included 4 or fewer dwelling units, such as a quadraplex, a duplex, or a single-family building. The OBBBA expanded that exemption of home construction contracts to include residential construction contracts, which are structures with more than 4 dwelling units. Typical condos, apartments, and other multifamily contracts are now exempt from the use of the PCM.

Residential construction contracts which were more than 2 years duration previously were required to use the PCM, with the option of the hybrid method called the percentage-of-completion / capitalized-cost method (PCCM) with a calculation of 70% on the PCM and 30% on the contractor's regular method. This was a complicated calculation but did provide some tax deferral. The new law exempts residential contracts similarly to the home construction contract previously. The 70/30 calculation is gone. A new costing requirement is added for contracts started after the date the law was passed for contracts that are longer than 3 years

The change from the PCCM may result in both the old method and the new method, for similar contracts, on the same tax return in the current year 2025 and following. Contracts started under the prior method will be completed under the prior method and contacts started after July 4, 2025 will be subject to the new rules. A residential construction contract started prior to the July date could be on the PCM or the elected PCCM, while a contract started after that date will be exempt from the PCM. The costing that is applicable to the older contract may be different from the costing rules of the newer contract. *And to make things more confusing*, if the residential construction contract is less than 3 years of estimated duration, the costing rules will be different than a similar contract that is expected to exceed 3 years. Here is a list of possible contract methods for contracts that are in progress this year, 2025 and forward: the PCM, the PCCM, the cash method, the completed-contract method, an accrual method, and the costing for these contracts may or may not include the Section 263A rules.

For more on this and other topics go to www.ConstructionDollarsAndSense.com

Questions or comments? Contact Al Clark at 404-252-2208 or AlClark@SmithAdcock.com

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