RACMP Enterprises, Inc. v. Commissioner, 114 T. C. 211 (2000)

Construction materials used by a contractor as an integral part of providing a service are not considered merchandise for tax accounting purposes.

Summary

RACMP Enterprises, a construction contractor, was audited by the IRS, which determined that the materials RACMP used in constructing concrete foundations and flatwork were 'merchandise' and thus required the company to use the accrual method of accounting. The Tax Court disagreed, ruling that RACMP's business was primarily a service, not a sale of goods. The materials were indispensable to and inseparable from the service provided, losing their separate identity upon incorporation into the real property. Therefore, RACMP could continue using the cash method of accounting, as it did not hold merchandise for sale.

Facts

RACMP Enterprises, Inc. , a licensed construction contractor, entered into contracts with real property developers to construct, place, and finish concrete foundations, driveways, and walkways. RACMP used the cash method of accounting, recognizing income when received and expensing materials when paid for. The IRS argued that the materials used by RACMP were 'merchandise,' necessitating the use of the accrual method. RACMP ordered materials specifically for each job, which were delivered directly to the construction site. The developers paid RACMP for the materials and labor upon completion of the work, with separate checks for materials and the remainder of the invoice.

Procedural History

The IRS audited RACMP for the tax year ending August 31, 1994, and determined that RACMP should use the accrual method of accounting due to its use of materials in construction. RACMP petitioned the U. S. Tax Court for a redetermination of the deficiency. The Tax Court ruled in favor of RACMP, affirming its use of the cash method of accounting.

Issue(s)

1. Whether the materials provided by RACMP in accordance with its contracts to construct and place concrete foundations, driveways, and walkways constitute 'merchandise' under section 1. 471-1 of the Income Tax Regulations.
2. Whether the IRS abused its discretion in determining that RACMP's use of the cash method of accounting did not clearly reflect its income.

Holding

1. No, because the materials were an indispensable and inseparable part of the

© 2025 SCOTUSreports.com. All rights reserved.

service provided by RACMP and lost their separate identity upon incorporation into the real property.
2. Yes, because RACMP's use of the cash method clearly reflected its income, and the IRS's determination was an abuse of discretion.

Court's Reasoning

The court applied the principle from *Osteopathic Med. Oncology & Hematology, P. C. v. Commissioner* that when the inherent nature of a business is service-based, materials integral to that service are not considered merchandise. The court found that RACMP's business was primarily a service, not the sale of goods. The materials were used up before being paid for and did not retain a separate identity once incorporated into the real property. The court rejected the IRS's argument that the materials were merchandise, stating that RACMP did not hold them for sale. The court also noted that the cash method had been widely accepted in the construction industry and that RACMP's method clearly reflected its income. The dissent argued that RACMP sold a finished product and should be required to account for materials as inventory.

Practical Implications

This decision clarifies that construction contractors who provide materials as an integral part of their service may continue to use the cash method of accounting without being required to account for materials as inventory. It reinforces the distinction between service providers and merchants in tax law, affecting how similar cases involving construction and other service-based industries should be analyzed. The ruling may influence business practices in the construction sector, potentially reducing the administrative burden of accrual accounting. Subsequent cases have cited this decision to support the use of the cash method by service providers using materials integral to their services.

© 2025 SCOTUSreports.com. All rights reserved.