Howard Hughes Co. , LLC v. Commissioner of Internal Revenue, 142 T. C. 355 (2014)

In Howard Hughes Co. , LLC v. Comm'r, the U. S. Tax Court ruled that the company's land sale contracts for a master-planned community were long-term construction contracts but not home construction contracts under IRC sec. 460(e). This meant the company could not use the completed contract method of accounting, impacting how it recognized income from land sales in Summerlin, Nevada. The decision clarifies the scope of the home construction contract exception, affecting developers and the timing of income recognition in similar real estate projects.

Parties

Howard Hughes Co. , LLC, and Howard Hughes Properties, Inc. , were the petitioners in this case. The Commissioner of Internal Revenue was the respondent. The petitioners were involved in a tax dispute regarding their method of accounting for income from land sales in the Summerlin master-planned community.

Facts

Howard Hughes Co. , LLC, and its subsidiaries (collectively, Howard Hughes) were engaged in developing and selling land in the Summerlin community in Las Vegas, Nevada. The land sales were categorized into bulk sales, pad sales, finished lot sales, and custom lot sales. Howard Hughes sold land to builders and individual purchasers, but did not construct residential units on the land sold. For the tax years 2007 and 2008, Howard Hughes reported income from these sales under the completed contract method of accounting, claiming the contracts qualified as home construction contracts under IRC sec. 460(e).

Procedural History

The Commissioner of Internal Revenue issued notices of deficiency to Howard Hughes for the tax years 2007 and 2008, asserting that Howard Hughes should use the percentage of completion method of accounting rather than the completed contract method. Howard Hughes timely petitioned the U. S. Tax Court for a redetermination of the deficiencies. The case was tried in Las Vegas, Nevada, and consolidated for trial, briefing, and opinion.

Issue(s)

Whether Howard Hughes's contracts for the sale of land in Summerlin qualify as long-term construction contracts under IRC sec. 460(f)(1)?
Whether Howard Hughes's contracts for the sale of land in Summerlin qualify as home construction contracts under IRC sec. 460(e)(6), thereby allowing the use of the completed contract method of accounting?

Rule(s) of Law

A long-term contract is defined by IRC sec. 460(f)(1) as “any contract for the manufacture, building, installation, or construction of property if such contract is not completed within the taxable year in which such contract is entered into. ” A home construction contract under IRC sec. 460(e)(6) is a construction contract where 80% or more of the estimated total contract costs are attributable to activities related to dwelling units in buildings containing four or fewer units and improvements to real property directly related to such units and located on the site of such dwelling units. The regulations further clarify that common improvement costs can be included in the cost of dwelling units if the taxpayer is obligated to construct them.

Holding

The Tax Court held that Howard Hughes’s bulk sale and custom lot contracts were long-term construction contracts under IRC sec. 460(f)(1). However, the court also held that Howard Hughes’s contracts were not home construction contracts within the meaning of IRC sec. 460(e)(6), and therefore, Howard Hughes could not use the completed contract method of accounting for these contracts.

Reasoning

The court reasoned that Howard Hughes’s contracts were long-term construction contracts because they involved the construction of property that was not completed within the taxable year the contracts were entered into. The court rejected the Commissioner’s argument that custom lot contracts were not long-term contracts because they were completed within the same tax year, finding that the subject matter of these contracts included more than just the sale of the lot, such as infrastructure improvements whose costs were allocable to the contracts.

Regarding the home construction contract exception, the court strictly construed the statute and regulations, finding that Howard Hughes’s contracts did not qualify because they did not involve the construction of dwelling units or improvements directly related to and located on the site of such units. The court determined that the costs Howard Hughes incurred were for common improvements and not attributable to the construction of dwelling units, as Howard Hughes did not build the homes or improvements on the lots sold. The court distinguished this case from Shea Homes, Inc. & Subs. v. Commissioner, where the taxpayer both developed land and constructed homes, allowing the inclusion of common improvement costs in the 80% test for home construction contracts.

The court also considered the legislative history and purpose behind the home construction contract exception, concluding that it was intended to benefit homebuilders who construct dwelling units, not land developers who only prepare the land for future construction by others. The court emphasized that allowing

Howard Hughes's interpretation would lead to an overly broad application of the exception, potentially resulting in indefinite deferral of income recognition.

Disposition

The Tax Court entered decisions for the respondent, the Commissioner of Internal Revenue, denying Howard Hughes's use of the completed contract method of accounting for the contracts at issue.

Significance/Impact

The Howard Hughes decision clarifies the scope of the home construction contract exception under IRC sec. 460(e)(6), impacting how land developers and builders account for income from land sales and construction projects. The ruling underscores that the exception is narrowly construed and applies primarily to taxpayers who directly construct qualifying dwelling units, not those who merely develop land for future construction by others. This case sets a precedent for distinguishing between land development and home construction activities for tax purposes, affecting the timing of income recognition and potentially influencing business strategies in real estate development. Subsequent cases and IRS guidance may further refine the application of the exception based on this decision.

