The Howard Hughes Co. , LLC v. Commissioner, 142 T. C. No. 20 (2014)

In a significant ruling, the U. S. Tax Court determined that The Howard Hughes Company, a land developer, could not use the completed contract method of accounting for its land sales contracts, as they did not qualify as home construction contracts under IRC section 460(e). The court clarified that only taxpayers directly involved in building homes or related improvements could use this method, impacting how land developers account for income from sales to homebuilders.

Parties

The Howard Hughes Company, LLC (formerly The Howard Hughes Corporation) and its subsidiaries, along with Howard Hughes Properties, Inc. , were the petitioners in these cases. They were engaged in residential land development in Las Vegas, Nevada. The respondent was the Commissioner of Internal Revenue, representing the interests of the U. S. government in tax matters.

Facts

The Howard Hughes Company and Howard Hughes Properties, Inc. , were involved in developing land in the Summerlin area of Las Vegas, Nevada. They sold land to builders and individuals through various methods including bulk sales, pad sales, finished lot sales, and custom lot sales. The company did not construct homes on the land sold but developed necessary infrastructure. For tax years 2007 and 2008, they reported income from these sales using the completed contract method of accounting, which the IRS challenged, asserting the percentage of completion method should be used instead.

Procedural History

The IRS issued notices of deficiency to The Howard Hughes Company and Howard Hughes Properties, Inc. , for the tax years 2007 and 2008, claiming they improperly used the completed contract method of accounting. The petitioners contested these deficiencies in the U. S. Tax Court, which consolidated the cases for trial, briefing, and opinion. The court reviewed the applicable law under IRC section 460 and considered whether the contracts qualified as home construction contracts.

Issue(s)

Whether the contracts for the sale of land by The Howard Hughes Company and Howard Hughes Properties, Inc. , qualify as home construction contracts under IRC section 460(e), allowing them to use the completed contract method of accounting?

Rule(s) of Law

IRC section 460(e) defines a home construction contract as one where 80% or more of the estimated total contract costs are attributable to activities related to building, constructing, reconstructing, or rehabilitating dwelling units or improvements directly related to such units. The regulations further clarify that these costs must be directly attributable to the construction of the dwelling units or related improvements.

Holding

The U. S. Tax Court held that the contracts of The Howard Hughes Company and Howard Hughes Properties, Inc. , did not qualify as home construction contracts under IRC section 460(e). Therefore, they could not use the completed contract method of accounting for their land sales. However, the court recognized that the custom lot contracts and bulk sale agreements were long-term construction contracts, allowing for the use of an alternative permissible method of accounting, such as the percentage of completion method.

Reasoning

The court’s reasoning focused on the interpretation of IRC section 460(e) and its regulations. The court determined that the costs incurred by The Howard Hughes Company were not directly attributable to the construction of dwelling units but rather to infrastructure development. The court emphasized that the completed contract method of accounting is a narrow exception intended for taxpayers directly involved in home construction, not land developers who do not build homes. The court also considered the legislative intent behind the home construction contract exception and found that it was meant to benefit homebuilders, not land developers. The court rejected the petitioners’ argument that their costs were related to and located on the site of the dwelling units, as they did not construct the homes or prove that qualifying dwelling units were built.

Disposition

The court entered decisions in favor of the respondent, the Commissioner of Internal Revenue, denying the petitioners’ use of the completed contract method of accounting for their land sales contracts.

Significance/Impact

This case clarifies the scope of the home construction contract exception under IRC section 460(e), impacting how land developers account for income from land sales to homebuilders. It establishes that only taxpayers directly involved in building homes or related improvements can use the completed contract method of accounting. The ruling may lead to changes in how land developers structure their contracts and account for income, potentially affecting their tax planning strategies. It also highlights the importance of strict interpretation of tax exceptions and the need for clear evidence that qualifying dwelling units will be constructed to qualify for such exceptions.