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Subject: Manufacturer's Method of Accounting

Please note that under current law manufacturers generally are not entitled to use the completed contract method of accounting (CCM). If the manufacturer's contract requires it to produce a "unique" item or one normally requiring more than 12 months to produce and the contract will not be completed within a single tax period, the contract is a long-term contract and generally must be accounted for under the percentage-of-completion method (PCM). See IRC sec. 460(f)(2), (a). On the other hand, if the item normally does not require more than 12 months to produce and is not unique (e.g., because one of the "safe harbors" in regulation section 1.460-2(b)(2) is met), then the contract is not a long-term contract and PCM need not be used. Under these circumstances, the manufacturer can account for the contract under an accrual method. CCM, however, can only be used to account for long-term contracts that are exempt from PCM (not contracts that do not qualify as long-term contracts). See Treas. Reg. Sec. 1.460-4(c). The primary examples of such "exempt" long-term contracts, which may be accounted for under CCM, are home construction contracts and the contracts of construction contractors with average annual gross receipts of less than $10 million that are expected to be completed within two years.

Please contact us with any further questions.