

**Title 12—DEPARTMENT OF REVENUE**  
**Division 10—Director of Revenue**  
**Chapter 2—Income Tax**

**12 CSR 10-2.230 Construction Contractors**

*PURPOSE: This rule sets forth the uniform provisions concerning multistate allocation and apportionment of income from construction contractors which were enacted by the Multistate Tax Commission.*

(1) General. When a taxpayer elects to use the percentage of completion method of accounting, or the completed contract method of accounting for long-term contracts (construction contracts covering a period in excess of one (1) year from the date of execution of the contract to the date on which the contract is finally completed and accepted) and has income from sources both within and without Missouri from a trade or business, the amount of business income derived from these long-term contracts from sources within Missouri shall be determined pursuant to this rule. In these cases, the first step is to determine which portion of the taxpayer's income constitutes business income and which portion constitutes nonbusiness income under section 32.200 (Article IV.1.), RSMo and the rules that interpret that provision. Nonbusiness income is directly allocated to specific states under section 32.200 (Article IV.4.–8.), RSMo and the rules that interpret those provisions. Business income is apportioned among the states in which the business is conducted pursuant to the property, payroll and sales apportionment factors set forth in this rule. The sum of the items of nonbusiness income directly allocated to Missouri plus the amount of business income attributable to Missouri, constitutes the amount of the taxpayer's entire net income which is subject to tax by Missouri.

(2) Business and Nonbusiness Income. For definitions, rules and examples for determining business and nonbusiness income, see 12 CSR 10-2.075.

(3) Methods of Accounting and Year of Inclusion. For general rules of accounting, definitions and methods of accounting, see sections 143.271–143.301, RSMo and the rules that interpret those provisions.

(4) Apportionment of Business Income. Business income is apportioned to Missouri by a three (3)-factor formula consisting of property, payroll and sales regardless of the method of accounting for long-term contracts elected by the taxpayer. The total of the property, payroll and sales percentages is divided by three (3) to determine the apportionment percentage. The apportionment percentage is then applied to business income to determine the amount apportioned to Missouri.

(A) Percentage of Completion Method. Under this method of accounting for long-term contracts, the amount to be included each year as business income from each contract is the amount by which the gross contract price which corresponds to the percentage of the entire contract which has been completed during the income year exceeds all expenditures made during the income year in connection with the contract. In so doing,

account must be taken of the material and supplies on hand at the beginning and end of the income year for use in each long-term contract.

1. Example: A taxpayer using the percentage of completion method of accounting for long-term contracts entered into a long-term contract to build a structure for \$9,000,000. The contract allowed three (3) years for completion and as of the end of the second income year the taxpayer's books of account, kept on the accrual method, disclosed the following:

	<b>Receipts</b>	<b>Expenditures</b>
End of 1st income year	\$2,500,000	\$2,400,000
End of 2nd income year	<u>\$4,500,000</u>	<u>\$4,100,000</u>
Totals	\$7,000,000	\$6,500,000

In computing these expenditures, consideration was given to material and supplies on hand at the beginning and end of each income year. It was estimated that the contract was thirty percent (30%) completed at the end of the first income year and eighty percent (80%) completed at the end of the second income year. The amount to be included as business income for the first income year is \$300,000 (30% of \$9,000,000 or \$2,700,000 less expenditures of \$2,400,000 equals \$300,000). The amount to be included as business income for the second income year is \$400,000 (50% of \$9,000,000 or \$4,500,000 less expenditures of \$4,100,000 equals \$400,000).

(B) Completed Contract Method. Under this method of accounting, business income derived from long-term contracts is reported for the income year in which the contract is finally completed and accepted. Therefore, a special computation is required to compute the amount of business income attributable to Missouri from each completed contract (see section (5) of this rule). All receipts and expenditures applicable to these contracts, whether complete or incomplete as of the end of the income year, are excluded from business income derived from other sources as, for example, short-term contracts, interest, rents, royalties, and the like, which are apportioned by the regular three (3)-factor formula of property, payroll and sales.

(C) Property Factor. In general, the numerator and denominator of the property factor shall be determined as set forth in section 32.200 (Article IV.10.–12.), RSMo and the rules that interpret those provisions. However, the following special rules are also applicable:

1. The average value of the taxpayer's cost (including materials and labor) of construction in progress, to the extent the costs exceed progress billings (accrued or received depending on whether the taxpayer is on the accrual or cash basis for keeping its accounts) shall be included in the denominator of the property factor. The value of any construction costs

attributable to construction projects in Missouri shall be included in the numerator of the property factor.

A. Example 1: Taxpayer commenced a long-term construction project in Missouri as of the beginning of a given year. By the end of its second income year, its equity in the costs of production to be reflected in the numerator and denominator of its property factor for that year is computed as follows:

	<b>1st Year</b>		<b>2nd Year</b>	
	<b>Beginning</b>	<b>Ending</b>	<b>Beginning</b>	<b>Ending</b>
Construction Costs	\$0	\$1,000,000		
Progress billings		<u>\$ 600,000</u>		
Balance 12/31—1/1		\$ 400,000	\$400,000	
Construction Costs—				
Total from beginning of project				\$5,000,000
Progress billings—				
Total from beginning of project				<u>\$4,000,000</u>
Balance 12/31				\$1,000,000
Balance beginning of year				<u>\$ 400,000</u>
Total				\$1,400,000
Average (1/2)—Value used in property factor				\$ 700,000

Note: It may be necessary to use monthly averages if yearly averages do not properly reflect the average value of the taxpayer's equity; see section 32.200 (Article IV.12.), RSMo and the rules that interpret that provision.

B. Example 2: Same facts as in subparagraph (4)(C)1.A. (Example 1) except that progress billings exceeded construction costs. No value for the taxpayer's equity in the construction project is shown in the property factor;

2. Rent paid for the use of equipment directly attributable to a particular construction project is included in the property factor at eight (8) times the net annual rental rate even though this rental expense may be capitalized into the cost of construction; and

3. The property factor is computed in the same manner for all long-term contract methods of accounting and is computed for each income year even though under the completed contract method of accounting, business income is computed separately (see section (5)).

(D) Payroll Factor. In general the numerator and denominator of the payroll factor shall be determined as set forth in section 32.200 (Article IV.13. and 14.), RSMo and the rules that interpret those provisions. However, the following special rules are also applicable:

1. Compensation paid employees which is attributable to a particular construction project is included in the payroll factor even though capitalized into the cost of construction;

2. Compensation paid employees who in the aggregate perform most of their services in a state to which their employer does not report them for unemployment tax purposes shall be attributed to the state where the services are performed.

A. Example: A taxpayer engaged in a long-term contract in state X sends several key employees to that state to supervise the project. The taxpayer, for unemployment tax purposes, reports these employees to state Y where the main office is maintained and where the employees reside. For payroll factor purposes and in accordance with section 32.200 (Article IV.14.), RSMo and the rules that interpret that provision, the compensation is assigned to the numerator of state X; and

3. The payroll factor is computed in the same manner for all long-term contract methods of accounting and is computed for each income year even though, under the completed contract method of accounting, business income is computed separately (see section (5)).

(E) Sales Factor. In general the numerator and denominator of the sales factor shall be determined as set forth in section 32.200 (Article IV.15.–17.), RSMo and the rules that interpret those provisions. However, the following special rules are also applicable:

1. Gross receipts derived from the performance of a contract are attributable to Missouri if the construction project is located in Missouri. If the construction project is located partly within and partly without Missouri, the gross receipts attributable to Missouri are based upon the ratio which construction costs for the project in Missouri incurred during the income year bear to the total of construction costs for the entire project during the income year or any other method, such as engineering cost estimates, which will provide a reasonable apportionment.

A. Example 1: A construction project was undertaken in Missouri by a calendar year taxpayer which had elected one (1) of the long-term contract methods of accounting. The following gross receipts (progress billings) were derived from the contract during the three (3) income years that contract was in progress:

	<u>1st Year</u>	<u>2nd Year</u>	<u>3rd Year</u>
Gross Receipts	\$1,000,000	\$4,000,000	\$3,000,000

The gross receipts to be reflected in both the numerator and denominator of the sales factor for each of the three (3) years are the amounts shown.

B. Example 2: A taxpayer contracts to build a dam on a river at a point which lies half within Missouri and half within state X. During the taxpayer's first income year construction costs in this state were \$2,000,000. Total construction costs for the project during the income year were \$3,000,000. Gross receipts (progress billings) for the year were \$2,400,000. Accordingly, gross receipts of \$1,600,000 ( $\$2,000,000 \div \$3,000,000 = 66 \frac{2}{3}\% \times \$2,400,000$ ) are included in the numerator of the sales factor;

2. If the percentage of completion method is used, the sales factor includes only that portion of the gross contract price which corresponds to the percentage of the entire contract which was completed during the income year.

A. Example: A taxpayer which had elected the percentage of completion method of accounting entered into a long-term construction contract. At the end of its current income year (the second since starting the project) it estimated that the project was thirty percent (30%) completed. The bid price for the project was \$9,000,000 and it had received \$2,500,000 from progress billings as of the end of its current income year. The amount of gross receipts to be included in the sales factor for the current income year is \$2,700,000 (30% of \$9,000,000), regardless of whether the taxpayer uses the accrual method or the cash method of accounting for receipts and disbursements;

3. If the completed contract method of accounting is used, the sales factor includes the portion of the gross receipts (progress billings) received or accrued, whichever is applicable, during the income year attributable to each contract.

A. Example 1: A taxpayer which had elected the completed contract method of accounting entered into a long-term construction contract. By the end of its current income year (the second since starting the project), it had billed and accrued on its books a total of \$5,000,000 of which \$2,000,000 had accrued in the first year the contract was undertaken and \$3,000,000 had accrued in the current (second) year. The amount of gross receipts to be included in the sales factor for the current income year is \$3,000,000.

B. Example 2: Same facts as in subparagraph (4)(E)3.A. (Example 1), except the taxpayer keeps its books on the cash basis and as of the end of its current income year had received only \$2,500,000 of the \$3,000,000 billed during the current year. The amount of gross receipts to be included in the sales factor for the current income year is \$2,500,000; and

4. The sales factor, except as noted in paragraphs (4)(E)2. and 3., is computed in the same manner, regardless of which long-term method of accounting the taxpayer has elected and is computed for each income year even though under the

completed contract method of accounting, business income is computed separately.

(F) Apportionment Percentage. The total of the property, payroll and sales percentages is divided by three (3) to determine the apportionment percentage. The apportionment percentage is then applied to business income to establish the amount apportioned to Missouri.

(5) Completed Contract Method—Special Computation. The completed contract method of accounting requires that the reporting of income (or loss) be deferred until the year the construction project is completed or accepted. Accordingly, a separate computation is made for each contract completed during the income year regardless of whether the project is located within or without Missouri in order to determine the amount of income which is attributable to sources within Missouri. The amount of income from each contract completed during the income year apportioned to Missouri plus other business income apportioned to Missouri by the regular three (3)-factor formula such as interest income, rents, royalties, income from shortterm contracts, and the like, plus all nonbusiness income allocated to Missouri is the measure of tax for the income year. The amount of income (or loss) from each contract which is derived from sources within Missouri using the completed contract method of accounting is computed as follows:

(A) In the income year the contract is completed, the income (or loss) is determined; and

(B) The income (or loss) determined in subsection (5)(A) is apportioned to Missouri by the following method:

1. A fraction is determined for each year the contract was in progress. The numerator is the amount of construction costs paid or accrued each year the contract was in progress, and the denominator is the total of all construction costs for the project;
2. Each percentage is multiplied by the apportionment formula percentage for that particular year as determined in subsection (4)(F) of this rule; and
3. The percentages determined for each year the contract was in progress are totaled. The amount of total income (or loss) from the contract determined in subsection (5)(A) is multiplied by the total percentage. The resulting income (or loss) is the amount of business income from the contract derived from sources within Missouri.

A. Example 1: A taxpayer using the completed contract method of accounting for long-term contracts is engaged in three (3) long-term contracts—Contract L in Missouri, Contract M in State X and Contract N in State Y. In addition, it has other business income (less expenses) during the income year 1990 from interest, rents and short-term contracts amounting to \$500,000 and nonbusiness income allocable to Missouri of \$8,000. During 1990 it completed Contract M in State X at a profit of

\$900,000. Contracts L and N in Missouri and State Y, respectively, were not completed during the income year. The apportionment percentages of the taxpayer as determined in subsection (4)(F) of this rule and the percentages of contract costs as determined in subsection (5)(B) for each year Contract M in State X was in progress and are as follows:

	<b>1988</b>	<b>1989</b>	<b>1990</b>
Apportionment percentages	30%	20%	40%
Percentages of construction costs of Contract M each year to total construction costs—(100%)	20%	50%	30%

The corporation's net income subject to tax in this state for 1990 is computed as follows:

Business Income	\$500,000
Apportion 40% to this state	\$200,000
Add: Income from Contract M*	\$252,000
Total business income derived from sources within this state	\$452,000
Add: Nonbusiness income allocated to this state	\$ 8,000
Net income subject to tax	\$460,000

\*Income from Contract M apportioned to this state

	<b>1988</b>	<b>1989</b>	<b>1990</b>	<b>TOTAL</b>
Apportionment percentage	30%	20%	40%	
Percent of construction costs	<u>20%</u>	<u>50%</u>	<u>30%</u>	<u>100%</u>
Product	6%	10%	12%	28%

\* 28% of \$900,000 = \$252,000

B. Example 2: Same facts as in subparagraph (5)(B)3.A. (Example 1) except that Contract L was started in 1990 in Missouri, the first year the taxpayer was subject to tax in Missouri. Contract L in Missouri and Contract N in state Y are incomplete in 1990.

The corporation's net income subject to tax in this state for 1990 is computed as follows:

Business income	\$500,000
Apportion 40% to this state	\$200,000
Add: Income from Contract M*	\$108,000
Total business income derived from sources within the state	\$308,000
Add: Nonbusiness income allocated to this state	\$ 8,000
Net income subject to tax	\$316,000

\*Income from Contract M apportioned to this state

	<b>1988</b>	<b>1989</b>	<b>1990</b>	<b>Total</b>
Apportionment percentage	0%	0%	40%	
Percent of Construction Costs	<u>20%</u>	<u>50%</u>	<u>30%</u>	<u>100%</u>
Product	0%	0%	12%	12%*

\*12% of \$900,000 = \$108,000

Note: Only 12% is used to determine the income derived from sources within this state since the corporation was not subject to tax in this state prior to 1990.

C. Example 3: Same facts as in subparagraph (5)(B)3.A. (Example 1) except that the figures relate to Contract L in Missouri and 1990 is the first year the corporation was taxable in another state (see section 32.200 (Article IV.2. and 3.), RSMo and the rules that interpret those provisions). Contracts M and N in states X and Y were started in 1990 and are incomplete. The corporation's net income subject to tax in Missouri for 1990 is computed as follows:

Business income	\$500,000
Apportion 40% to this state	\$200,000
Add: Income for Contract L*	\$738,000
Total business income derived from sources within this state	\$938,000
Add: Nonbusiness income allocated to this state	\$ 8,000
Net income subject to tax	\$946,000

\*Income from Contract L apportioned to this state

	<b>1988</b>	<b>1989</b>	<b>1990</b>	<b>Total</b>
Apportionment Percentage	100%	100%	40%	
Percentage of Construction Costs	<u>20%</u>	<u>50%</u>	<u>30%</u>	<u>100%</u>
Product	20%	50%	12%	82%*

82% of \$900,000 = \$738,000

(6) Computation for Year of Withdrawal, Dissolution or Cessation of Business—Completed Contract Method. Use of the completed contract method of accounting for long-term contracts requires that income derived from sources within Missouri from incomplete contracts in progress outside Missouri on the date of withdrawal, dissolution or cessation of business in Missouri be included in the measure of tax for the taxable year during which the corporation withdraws, dissolves or ceases doing business in Missouri.

(A) The amount of income (or loss) from each contract to be apportioned to this state by the apportionment method set forth in subsection (5)(B) of this rule shall be determined, as if the percentage of completion method of accounting were used, for all contracts on the date of withdrawal, dissolution or cessation of business. The amount of business income (or loss) for each contract shall be the amount by which the gross contract price from each contract which corresponds to the percentage of the entire contract which has

been completed from the commencement of the contract to the date of withdrawal, dissolution or cessation of business exceeds all expenditures made during this period in connection with each contract. In so doing, account must be taken of the material and supplies on hand at the beginning and end of the income year for use in each contract.

1. Example: A construction contractor qualified to do business in Missouri had elected the completed contract method of accounting for long-term contracts. It was engaged in two (2) long-term contracts. Contract L in Missouri was started in 1988 and completed at a profit of \$900,000 on December 16, 1990. The taxpayer withdrew on December 31, 1990. Contract M in state X was started in 1990 and was incomplete on December 31, 1990. The apportionment percentages of the taxpayer as determined in subsection (4) of this rule and percentages of construction costs are determined in subsection (5)(B) of this rule for each year Contract M in state X was in progress and are as follows:

	1988	1989	1990	Total
Apportionment percentage	30%	20%	40%	
Percentages of construction costs				
Contract L, Missouri	<u>20%</u>	<u>50%</u>	<u>30%</u>	<u>100%</u>
Contract M, State X	0%	10%	25%	35%

The corporation had other business income (net of expenses) of \$500,000 during 1989 and \$300,000 during 1990. The gross contract price of Contract M (State X) was \$1,000,000 and it was estimated to be 35% completed on December 31, 1990. Total expenditures to date for Contract M (State X) were \$300,000 for the period ended December 31, 1990.

The measure of tax for the taxable year ended December 31, 1990 is computed as follows:

	<b>1988</b>	<b>1989</b>	<b>1990</b>	<b>Total</b>
Apportionment percentage	30%	20%	40%	
Percentages of construction costs				
Contract L, Missouri	20%	50%	30%	100%
Contract M, State X	0%	10%	25%	35%

The corporation had other business income (net of expenses) of \$500,000 during 1989 and \$300,000 during 1990. The gross contract price of Contract M (State X) was \$1,000,000 and it was estimated to be 35% completed on December 31, 1990. Total expenditures to date for Contract M (State X) were \$300,000 for the period ended December 31, 1990.

The measure of tax for the taxable year ended 12/31/90 is computed as follows:

	Taxable Year 1990	
	Income Year 1990	Income Year 1990
Business income	\$500,000	\$300,000
Apportionment percentage to this state	20%	40%
Amount apportioned to this state	\$100,000	\$120,000
Add: Income from Contracts *L (Missouri)	\$252,000	
**M (State X)	\$ 6,000	
Total business income derived from sources within this state	\$100,000	\$378,000

\*Income from Contract L apportioned to this state

	1988	1989	1990	Total
Apportionment percentages	30%	20%	40%	
Percentage of construction costs	20%	50%	30%	100%
Product	6%	10%	12%	28%
28% of \$900,000 = \$252,000				

\*\*Income from Contract M apportioned to this state

	1988	1989	1990	Total
Apportionment percentages	0%	20%	40%	
Percentage of construction costs	0%	10%	25%	35%
Product	0%	2%	10%	12%***

\*\*\*12.0% of \$50,000 = \$6,000

\*\*\*Computation of apportionable income from Contract M based on percentage of completion method: Total contract price \$1,000,000 Estimated to be 35% completed \$ 350,000 Less: Total expenditures to date \$ 300,000 Apportionable income \$ 50,000

*AUTHORITY: sections 32.200 (Article VII) and 143.961, RSMo 1994. \* Original rule filed Dec. 17, 1990, effective April 29, 1991.*

*\*Original authority: 32.200, RSMo 1967 and 143.961, RSMo 1972.*