

# The Average Annual Gross Receipts Test: A Key Tax Planning Strategy for Contractors in 2024

December 12, 2024



The average annual gross receipts test is a method used by the IRS to determine whether a business qualifies for certain tax benefits, particularly for small businesses. Contractors use the average annual gross receipts test to determine which accounting methods can be used in recognizing taxable income.

In 2024, the threshold for the test has increased to \$30 million—making more businesses eligible for these benefits and enhancing the overall flexibility in their tax planning. It is important to note that the average annual gross receipts test is the 3-year average of revenue reported on tax returns.

When computing the gross receipts test, revenue from affiliates must also be included, and the amounts included depend on ownership percentages.

## Tax Planning for Contractors

The first step in proper tax planning is to consider the accounting method used to report the business' taxable income. Contractors must use the percentage of completion method for long-term contracts, which recognizes revenue as work is

performed. Long-term contracts are defined as any construction contract started and not completed in the same tax year. If the average annual gross receipts test is met and depending on the expected length of the contract, a choice of exempt accounting methods can be used to defer the income.

With the increase to the test's gross receipts threshold, contractors may have an opportunity to change their method and create tax deferrals to leave more cash in their company.

### *Average Annual Gross Receipts are Below the Threshold*

If a company's 3-year average annual gross receipts are under \$30 million, and it starts a contract that is expected to be completed within 24 months, it has several choices to elect as its "exempt method" for reporting long-term contracts and as an overall accounting method. A company's accounting method for long-term contracts could be different **from** its overall method. Each situation is different, so a thorough analysis should be done to determine what the *best* method is for the business.

### *Average Annual Gross Receipts Exceed the Threshold*

It is important to note that there are other tax deferral strategies available that can be used to reduce tax liabilities even if a company's average annual gross receipts exceed \$30 million. A change of method for long-term contracts is done on a "cutoff" method. A "cutoff" method allows the new jobs that start in the current year to be reported for tax purposes on the new exempt method, and jobs previously in process to continue the method they were using in the past.

## **Next Steps and Conclusion**

The accounting method change form, Form 3115, may or may not be required depending on the company's current and prior year average annual gross receipts test. Depending on the type of method change and the desire to have the change be effective for contracts started in 2024, it could be required to file by December 31, 2024. Please note, fiscal year taxpayers will have different due dates.

If a change in accounting method is decided, this change will not impact the method

of reporting income on the financial statement. The financial statement reporting follows Generally Accepted Accounting Principles (GAAP), while the tax returns follow the Internal Revenue Code.

In summary, it's important for contractors to maximize deferrals and tax savings to have more cash on hand for day-to-day operations and potential additional investments. This starts with the accounting method used to report taxable income.

For more information on the annual gross receipts test or year-end tax planning, please reach out to [\*\*Joseph Molloy\*\*](#) or your Anchin Relationship Partner.