

Chapter 11: Contractor Square Foot Costs

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Introduction

Latest estimates put the Federal tax gap at \$345 billion and growing. The tax gap is equivalent to a noncompliance rate of 16.3%. Of this amount, \$285 billion is attributable to underreporting of business income of which \$68 billion is attributable to sole-proprietors (Individual Income Tax, Form 1040, Schedule C). This amount represents the single largest source of the entire tax gap and is a direct result of little or no information reporting. Consequently, matching of income received to income reported cannot be performed.

In addressing the tax gap attributable to the construction industry, residential construction is of particular interest because this group of taxpayers accounts for 73% of the return filings but reports only 10% of the gross receipts. It is imperative that steps are taken to ensure that only the most noncompliant returns enter the examination stream and that appropriate issues, specifically underreporting of income, are examined in a quality manner. Of particular interest are cash intensive businesses. The Service is especially concerned with sole-proprietorships because they often lack internal controls and cash can easily go unreported. In addition, records can be either non-existent or inadequate. For example, cash receipts may not be deposited into the business bank account.

For this purpose, it is important to pursue alternative methods of addressing the underreporting of business income on residential construction returns. This can be achieved, in part, by utilizing innovative methodologies such as Residential Square Foot Costs and the Market-based Profit Markup when warranted. These methods are efficient and effective at estimating profit when taxpayers are not cooperative or their books and records are either non-existent or inadequate.

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It uses an Assemblies or sometimes referred to as systems format grouping all the functional elements of residential construction into nine construction divisions. Costs shown in the Means guide is based on national averages for materials and installation; however, material costs include a standard 10% markup for profit. These costs are national average material costs for January 2007 and include delivery to the job site. Installation costs include labor and equipment, plus a markup of 70.6% for the installing contractor's overhead and profit.

"Costs per square foot" estimate for commonly constructed systems within the residential construction industry. You can arrive at a more accurate estimate by adding, removing or adjusting items to the system estimate to reflect the actual specifications of the work performed. These costs can also be adjusted to a specific location by applying the appropriate Location Factor. As noted in that section, simply multiply the cost by the location factor for a specific city. State and postal zip code number data is arranged alphabetically. For a city that is not listed, use the factor for a nearby city with similar economic characteristics. In summary, total project costs can be adjusted to over 900 locations throughout the U.S. and Canada. See the location factors section in this chapter.