

Internal Revenue Service, Treasury

§ 1.461-0

Total contract costs	\$1,000e
Total contract price	\$2,000e
1986 completion (%)	40e
1986 gross income	\$800a
less, 1986 costs	(\$400a)
1986 net contract income	\$400a
Other 1986 net income	\$2,000a
Taxable income (NOL)	\$2,400a
Tax at 46%	\$1,104a

C determines its tax liability for 1987 as follows:

1987 contract costs	\$400a
Total contract costs	\$1,066e
Total contract price	\$2,000e
1987 completion (%)	75e
1987 gross income	\$700a
Less, 1987 costs	(\$400a)
1987 net contract income	\$300a
Other 1987 net income	(\$2,450a)
Taxable income (NOL)	(\$2,150a)
Tax	\$10a

C carries back the net operating loss to 1986, and files an amended return for 1986, showing taxable income of \$250, and receives a refund of \$989 (46% × \$2,150). Interest on this refund begins to run only as of the due date of C's 1987 return. See section 6611(f).

In 1988, when the contract is completed, C determines the following amounts:

1988 contract costs	\$800a
Total contract costs	\$1,600a
Total contract price	\$2,000a

If C had used actual contract price and contract costs in determining gross income for 1986, it would have reported gross income from the contract of \$500 rather than \$800, taxable income of \$2,100 rather than \$2,400, and tax liability of \$966 rather than \$1,104.

If C had used actual contract price and contract costs in determining gross income for 1987, it would have reported gross income from the contract of \$500 rather than \$700, and would have reported a net operating loss of \$2,350, rather than \$2,150, which would have been carried back to 1986.

Under the look-back method, C receives interest with respect to a total 1986 hypothetical overpayment of \$138 (\$1,104 minus \$966). C is credited with interest on \$23 of this amount only from the due date of C's 1986 return until the due date of C's 1987 tax return, because this portion of C's total hypothetical overpayment for 1986 was refunded to C with interest computed from the due date of C's 1987 return and, therefore, was no longer held by the government. However, because the remainder of the total hypothetical overpayment of \$115 was not refunded to C, C is credited with interest on this amount from the due date of C's 1986 return until the due date of C's 1988 tax return.

Under the look-back method, C receives no interest with respect to 1987, because C had no tax liability for 1987 using either estimated or actual contract price and costs.

(i) [Reserved]

(j) *Election not to apply look-back method in de minimis cases.* Section 460(b)(6) provides taxpayers with an election not to apply the look-back method to long-term contracts in de minimis cases, effective for contracts completed in taxable years ending after August 5, 1997. To make an election, a taxpayer must attach a statement to its timely filed original federal income tax return (including extensions) for the taxable year the election is to become effective or to an amended return for that year, provided the amended return is filed on or before March 31, 1998. This statement must have the legend "NOTIFICATION OF ELECTION UNDER SECTION 460(b)(6)"; provide the taxpayer's name and identifying number and the effective date of the election; and identify the trades or businesses that involve long-term contracts. An election applies to all long-term contracts completed during and after the taxable year for which the election is effective. An election may not be revoked without the Commissioner's consent. For taxpayers who elected to use the delayed reapplication method under paragraph (e) of this section, an election under this paragraph (j) automatically revokes the election to use the delayed reapplication method for contracts subject to section 460(b)(6). A consolidated group of corporations, as defined in § 1.1502-1(h), is subject to consistency rules analogous to those in paragraph (e)(2) of this section and in paragraph (d)(4)(ii)(C) of this section (concerning election to use simplified marginal impact method).

[T.D. 8315, 55 FR 41670, Oct. 15, 1990, as amended by T.D. 8775, 63 FR 36181, July 2, 1998; T.D. 8929, 66 FR 2240, Jan. 11, 2001]

TAXABLE YEAR FOR WHICH DEDUCTIONS TAKEN

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This section lists the captions that appear in the regulations under section 461 of the Internal Revenue Code.

§ 1.461-1 General rule for taxable year of deduction.

(a) General rule.

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- (b) Contest of asserted liability.
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- (c) Transfer to provide for the satisfaction of an asserted liability.
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 - (f) Treatment of money or property transferred to an escrowee, trustee, or court and treatment of any income attributable thereto. [Reserved]
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§ 1.461-4 Economic performance.

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 - (1) [Reserved]
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§ 1.461-5 Recurring item exception.

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§ 1.461-6 Economic performance when certain liabilities are assigned or are extinguished by the establishment of a fund.

(a) Qualified assignments of certain personal injury liabilities under section 130.

(b) Section 468B.

(c) Payments to other funds or persons that constitute economic performance. [Reserved]

(d) Effective dates.

[T.D. 8408, 57 FR 12420, Apr. 10, 1992, as amended by T.D. 8593, 60 FR 18743, Apr. 13, 1995]

§ 1.461-1 General rule for taxable year of deduction.

(a) *General rule*—(1) *Taxpayer using cash receipts and disbursements method.* Under the cash receipts and disbursements method of accounting, amounts representing allowable deductions shall, as a general rule, be taken into account for the taxable year in which paid. Further, a taxpayer using this method may also be entitled to certain deductions in the computation of taxable income which do not involve cash disbursements during the taxable year, such as the deductions for depreciation, depletion, and losses under sections 167, 611, and 165, respectively. If an expenditure results in the creation of an asset having a useful life which extends substantially beyond the close of the taxable year, such an expenditure may not be deductible, or may be deductible only in part, for the taxable year in which made. An example is an expenditure for the construction of improvements by the lessee on leased property where the estimated life of the improvements is in excess of the remaining period of the lease. In such a case, in lieu of the allowance for depreciation provided by section 167, the basis shall be amortized ratably over the remaining period of the lease. See section 178 and the regulations thereunder for rules governing the effect to be given renewal options in determining whether the useful life of the improvements exceeds the remaining term of the lease where a lessee begins improvements on leased property after July 28, 1958, other than improvements which on such date and at all times thereafter, the lessee was under a binding legal obligation to make. See section 263 and the regulations thereunder for rules relating to capital expendi-

tures. See section 467 and the regulations thereunder for rules under which a liability arising out of the use of property pursuant to a section 467 rental agreement is taken into account.

(2) *Taxpayer using an accrual method*—(i) *In general.* Under an accrual method of accounting, a liability (as defined in § 1.446-1(c)(1)(ii)(B)) is incurred, and generally is taken into account for Federal income tax purposes, in the taxable year in which all the events have occurred that establish the fact of the liability, the amount of the liability can be determined with reasonable accuracy, and economic performance has occurred with respect to the liability. (See paragraph (a)(2)(iii)(A) of this section for examples of liabilities that may not be taken into account until a taxable year subsequent to the taxable year incurred, and see §§ 1.461-4 through 1.461-6 for rules relating to economic performance.) Applicable provisions of the Code, the Income Tax Regulations, and other guidance published by the Secretary prescribe the manner in which a liability that has been incurred is taken into account. For example, section 162 provides that the deductible liability generally is taken into account in the taxable year incurred through a deduction from gross income. As a further example, under section 263 or 263A, a liability that relates to the creation of an asset having a useful life extending substantially beyond the close of the taxable year is taken into account in the taxable year incurred through capitalization (within the meaning of § 1.263A-1(c)(3)), and may later affect the computation of taxable income through depreciation or otherwise over a period including subsequent taxable years, in accordance with applicable Internal Revenue Code sections and guidance published by the Secretary. The principles of this paragraph (a)(2) also apply in the calculation of earnings and profits and accumulated earnings and profits.

(ii) *Uncertainty as to the amount of a liability.* While no liability shall be taken into account before economic performance and all of the events that fix the liability have occurred, the fact that the exact amount of the liability cannot be determined does not prevent a taxpayer from taking into account