

[4830-01-u]

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Parts 1 and 602

[TD 8756]

RIN 1545-AV78

Election Not to Apply Look-Back Method in De Minimis Cases

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final and temporary regulations.

SUMMARY: This document contains final and temporary regulations explaining how a taxpayer elects under section 460(b)(6) not to apply the look-back method to long-term contracts in de minimis cases. The regulations reflect changes to the law made by the Taxpayer Relief Act of 1997 and affect manufacturers and construction contractors whose long-term contracts otherwise are subject to the look-back method. The text of the temporary regulations also serves as the text of the proposed regulations set forth in the notice of proposed rulemaking on this subject in the Proposed Rules section of this issue of the Federal Register.

DATES: These regulations are effective January 13, 1998.

These regulations apply to long-term contracts completed in taxable years ending after August 5, 1997.

FOR FURTHER INFORMATION CONTACT: Leo F. Nolan II or John M. Aramburu at (202) 622-4960 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

These regulations are being issued without prior notice and public procedure pursuant to the Administrative Procedure Act (5 U.S.C. 553). For this reason, the collection of information contained in these regulations has been reviewed and, pending receipt and evaluation of public comments, approved by the Office of Management and Budget (OMB) under control number 1545-1572. Responses to this collection of information are required for a taxpayer to elect not to apply the look-back method to long-term contracts in de minimis cases.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid OMB control number.

For further information concerning this collection of information, and where to submit comments on the collection of information and the accuracy of the estimated burden, and suggestions for reducing the burden, please refer to the preamble in the cross-referencing notice of proposed rulemaking published in the Proposed Rules section of this

issue of the Federal Register.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Background

This document contains amendments to the Income Tax Regulations (26 CFR Part 1). Section 460(b)(6) of the Internal Revenue Code was added by section 1211 of the Taxpayer Relief Act of 1997, Public Law 105-34, 111 Stat. 788, 998, to provide an election not to apply the look-back method of section 460(b)(2) to long-term contracts in de minimis cases. These regulations provide guidance concerning this new election.

Explanation of Provisions

Section 460(b) provides that, upon the completion of any long-term contract, the look-back method is applied to amounts reported under the contract using the percentage-of-completion method (PCM). The PCM requires the use of estimates of total contract price and total contract costs for reporting income in taxable years preceding the year of contract completion. The look-back method is intended to offset the time-value-of-money effects of using estimates during the life of a contract that differ from the actual amounts determined in the year of contract completion.

Under the look-back method, taxpayers are required to pay interest if a tax liability is deferred as a result of underestimating the total contract price or overestimating total contract costs. Conversely, taxpayers are entitled to receive interest if a tax liability is accelerated as a result of overestimating the total contract price or underestimating total contract costs.

Section 1.460-6(e) contains an elective relief provision concerning the look-back method, which is called the delayed reapplication method. Under the delayed reapplication method, a taxpayer does not apply the look-back method to any post-completion taxable year until the first of the following conditions is met: (1) the net undiscounted value of increases or decreases in the contract price occurring since the last application of the look-back method exceeds the lesser of \$1,000,000 or 10 percent of the total contract price as of that time; (2) the net undiscounted value of increases or decreases in the contract costs occurring since the last application of the look-back method exceeds the lesser of \$1,000,000 or 10 percent of the total actual contract costs as of that time; (3) the taxpayer goes out of existence; (4) the taxpayer reasonably believes the contract is finally settled and closed; or (5) five taxable years have passed since the last application of the look-back method.

In the Taxpayer Relief Act of 1997, section 460(b)(6)

was added to provide taxpayers with an election not to apply the look-back method to long-term contracts in either of the following cases (de minimis cases). First, a taxpayer does not apply the look-back method in the completion year if, for each prior contract year, the cumulative taxable income (or loss) actually reported under the contract is within 10 percent of the cumulative look-back income (or loss).

Cumulative look-back income (or loss) is the amount of taxable income (or loss) that the taxpayer would have reported if the taxpayer had used actual contract price and costs instead of estimated contract price and costs.

Second, a taxpayer does not apply the look-back method in a post-completion taxable year if, as of the close of the post-completion taxable year, the cumulative taxable income (or loss) under the contract is within 10 percent of the cumulative look-back income (or loss) under the contract as of the close of the most recent year in which the look-back method was applied to the contract (or would have been applied but for this election).

These temporary regulations provide that a taxpayer may elect not to apply the look-back method to long-term contracts in de minimis cases by attaching a statement to the taxpayer's timely filed federal income tax return (including extensions) for the taxable year the election is effective or to an amended return for that year, provided the amended return is filed on or before March 31, 1998.

This election applies to all long-term contracts completed during and after the year of election, unless the Commissioner consents to the revocation of the election.

These temporary regulations apply to long-term contracts completed in taxable years ending after August 5, 1997.

Special Analyses

It has been determined that this final and temporary regulation is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It is hereby certified that the collection of information in these regulations will not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that the time required to prepare and file an election statement is minimal and will not have a significant impact on those small entities that choose to make the election. In addition, the election need only be made once by a taxpayer. Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Internal Revenue Code, this final and temporary regulation will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal author of these final and temporary regulations is Leo F. Nolan II, Office of Assistant Chief Counsel (Income Tax and Accounting). However, other personnel from the IRS and Treasury Department participated in their development.

List of Subjects

26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

26 CFR Part 602

Reporting and recordkeeping requirements.

Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1--INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by adding an entry for Section 1.460-6T in numerical order to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

§1.460-6T also issued under 26 U.S.C. 460(h). * * *

Par. 2. Section 1.460-0 is amended by adding an entry for §1.460-6T to read as follows:

§1.460-0 Outline of regulations under section 460.

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§1.460-6T Look-back method (temporary).

(a) through (i) [Reserved]

(j) Election not to apply look-back method in de

minimis cases.

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Par. 3. Section 1.460-6T is added to read as follows:
§1.460-6T Look-back method (temporary).

(a) through (h) [Reserved] For further guidance, see §1.460-6(a) through (h).

(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. A consolidated group of corporations, as defined in §1.1502-1(h), is

subject to consistency rules analogous to those in §1.460-6(e)(2) (concerning election to use delayed reapplication method) and in §1.460-6(d)(4)(ii)(C) (concerning election to use simplified marginal impact method).

PART 602--OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 4. The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 5. In §602.101, paragraph (c) is amended by adding an entry to the table in numerical order to read as follows:

§602.101 OMB Control numbers.

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(c) * * *

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| CFR part or section where | Current OMB |
| identified and described | control No. |

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| 1.460-6T(j)..... | 1545-1572 |
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Michael P. Dolan
Deputy Commissioner of Internal Revenue

Approved: December 18, 1997

Donald C. Lubick
Acting Assistant Secretary of the Treasury