

section 458, the qualified sales relating to magazines are considered one trade or business and the qualified sales relating to paperbacks are considered a separate trade or business. Thus, if the taxpayer wishes to account under section 458 for the qualified sales of both magazines and paperbacks, such taxpayer must make a separate election for each category.

(c) *Manner of, and time for, making election.* An election is made under section 458 and this section by filing a statement of election containing the information described in paragraph (d) of this section with the taxpayer's income tax return for first taxable year for which the election is made. The election must be made no later than the time prescribed by law (including extensions) for filing the income tax return for the first taxable year for which the election is made. Thus, the election may not be filed with an amended income tax return after the prescribed date (including extensions) for filing the original return for such year.

(d) *Required information.* The statement of election required by paragraph (c) of this section must indicate that an election is being made under section 458(c) and must set forth the following information:

- (1) The taxpayer's name, address, and identification number;
- (2) A description of each trade or business for which an election is made;
- (3) The first taxable year for which an election is made for each trade or business;
- (4) The merchandise return period (as defined in section 458(b)(7)) for each trade or business for which an election is made;
- (5) With respect to an election that applies to magazines, the amount of the adjustment computed under section 481(a) resulting from the change to the method of accounting described in section 458; and
- (6) With respect to an election that applies to paperbacks or records, the initial opening balance (computed in accordance with section 458(e)) in the suspense account for each trade or business for which an election is made. The statement of election should be made on a Form 3115 which need con-

tain no information other than that required by this paragraph.

[T.D. 7628, 44 FR 33398, June 11, 1979. Redesignated by T.D. 8426, 57 FR 38599, Aug. 26, 1992]

#### § 1.460-0 Outline of regulations under section 460.

This section lists the paragraphs contained in § 1.460-1 through § 1.460-6.

##### § 1.460-1 Long-term contracts.

- (a) Overview.
  - (1) In general.
  - (2) Exceptions to required use of PCM.
    - (i) Exempt construction contract.
    - (ii) Qualified ship or residential construction contract.
  - (b) Terms.
    - (1) Long-term contract.
    - (2) Contract for the manufacture, building, installation, or construction of property.
      - (i) In general.
      - (ii) De minimis construction activities.
    - (3) Allocable contract costs.
    - (4) Related party.
    - (5) Contracting year.
    - (6) Completion year.
    - (7) Contract commencement date.
    - (8) Incurred.
    - (9) Independent research and development expenses.
    - (10) Long-term contract methods of accounting.
      - (c) Entering into and completing long-term contracts.
        - (1) In general.
        - (2) Date contract entered into.
          - (i) In general.
          - (ii) Options and change orders.
        - (3) Date contract completed.
          - (i) In general.
          - (ii) Secondary items.
            - (iii) Subcontracts.
            - (iv) Final completion and acceptance.
              - (A) In general.
              - (B) Contingent compensation.
              - (C) Assembly or installation.
              - (D) Disputes.
          - (d) Allocation among activities.
            - (1) In general.
            - (2) Non-long-term contract activity.
          - (e) Severing and aggregating contracts.
            - (1) In general.
            - (2) Facts and circumstances.
              - (i) Pricing.
                - (ii) Separate delivery or acceptance.
                - (iii) Reasonable businessperson.
              - (3) Exceptions.
                - (i) Severance for PCM.
                - (ii) Options and change orders.
              - (4) Statement with return.
              - (f) Classifying contracts.
                - (1) In general.
                - (2) Hybrid contracts.
                  - (i) In general.

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- (ii) Elections.
- (3) Method of accounting.
- (4) Use of estimates.
- (i) Estimating length of contract.
- (ii) Estimating allocable contract costs.
- (g) Special rules for activities benefitting long-term contracts of a related party.
  - (1) Related party use of PCM.
  - (i) In general.
  - (ii) Exception for components and sub-assemblies.
  - (2) Total contract price.
  - (3) Completion factor.
  - (h) Effective date.
  - (1) In general.
  - (2) Change in method of accounting.
  - (i) [Reserved]
  - (j) Examples.

*§ 1.460-2 Long-term manufacturing contracts.*

- (a) In general.
- (b) Unique.
  - (1) In general.
  - (2) Safe harbors.
- (i) Short production period.
- (ii) Customized item.
- (iii) Inventoried item.
- (c) Normal time to complete.
  - (1) In general.
  - (2) Production by related parties.
- (d) Qualified ship contracts.
- (e) Examples.

*§ 1.460-3 Long-term construction contracts.*

- (a) In general.
- (b) Exempt construction contracts.
  - (1) In general.
  - (2) Home construction contract.
- (i) In general.
- (ii) Townhouses and rowhouses.
- (iii) Common improvements.
- (iv) Mixed use costs.
- (3) \$10,000,000 gross receipts test.
  - (i) In general.
  - (ii) Single employer.
  - (iii) Attribution of gross receipts.
- (c) Residential construction contracts.

*§ 1.460-4 Methods of accounting for long-term contracts.*

- (a) Overview.
- (b) Percentage-of-completion method.
  - (1) In general.
  - (2) Computations.
  - (3) Post-completion-year income.
  - (4) Total contract price.
- (i) In general.
- (A) Definition.
- (B) Contingent compensation.
- (C) Non-long-term contract activities.
- (ii) Estimating total contract price.
- (5) Completion factor.
  - (i) Allocable contract costs.
  - (ii) Cumulative allocable contract costs.
  - (iii) Estimating total allocable contract costs.

- (iv) Pre-contracting-year costs.
- (v) Post-completion-year costs.
- (6) 10-percent method.
  - (i) In general.
  - (ii) Election.
- (7) Terminated contract.
  - (i) Reversal of income.
  - (ii) Adjusted basis.
  - (iii) Look-back method.
- (c) Exempt contract methods.
  - (1) In general.
  - (2) Exempt-contract percentage-of-completion method.
    - (i) In general.
    - (ii) Determination of work performed.
  - (d) Completed-contract method.
    - (1) In general.
    - (2) Post-completion-year income and costs.
    - (3) Gross contract price.
    - (4) Contracts with disputed claims.
      - (i) In general.
      - (ii) Taxpayer assured of profit or loss.
      - (iii) Taxpayer unable to determine profit or loss.
      - (iv) Dispute resolved.
    - (e) Percentage-of-completion/capitalized-cost method.
      - (1) In general.
      - (2) Election to use regular completion factors.
    - (g) Method of accounting.
    - (h) Examples.
    - (i) [Reserved]
    - (j) Consolidated groups and controlled groups.
      - (1) Intercompany transactions.
        - (i) In general.
        - (ii) Definitions and nomenclature.
      - (2) Example.
      - (3) Effective dates.
        - (i) In general.
        - (ii) Prior law.
      - (4) Consent to change method of accounting.
        - (k) Mid-contract change in taxpayer.
          - (1) In general.
        - (2) Constructive completion transactions.
          - (i) Scope.
          - (ii) Old taxpayer.
          - (iii) New taxpayer.
          - (iv) Special rules relating to distributions of certain contracts by a partnership.
            - (A) In general.
            - (B) Old taxpayer.
            - (C) New taxpayer.
            - (D) Basis rules.
            - (E) Section 751.
            - (F) In general.
          - (2) Ordering rules.
          - (3) Step-in-the-shoes transactions.
            - (i) Scope.
            - (ii) Old taxpayer.
              - (A) In general.
              - (B) Gain realized on the transaction.
              - (iii) New taxpayer.
            - (A) Method of accounting.

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- (B) Contract price.
- (C) Contract costs.
- (iv) Special rules related to certain corporate and partnership transactions.
  - (A) Old taxpayer—basis adjustment.
  - (1) In general.
  - (2) Basis adjustment in excess of stock or partnership interest basis.
  - (3) Subsequent dispositions of certain contracts.
    - (B) New taxpayer.
    - (1) Contract price adjustment.
    - (2) Basis in contract.
  - (C) Definition of old taxpayer and new taxpayer for certain partnership transactions.
  - (D) Exceptions to step-in-the-shoes rules for S corporations.
  - (v) Special rules relating to certain partnership transactions.
    - (A) Section 704(c).
    - (1) Contributions of contracts.
    - (2) Revaluations of partnership property.
    - (3) Allocation methods.
    - (B) Basis adjustments under sections 743(b) and 734(b).
    - (C) Cross reference.
    - (D) Exceptions to step-in-the-shoes rules.
    - (4) Anti-abuse rule.
    - (5) Examples.
    - (6) Effective date.

*§ 1.460-5 Cost allocation rules.*

- (a) Overview.
- (b) Cost allocation method for contracts subject to PCM.
  - (1) In general.
  - (2) Special rules.
    - (i) Direct material costs.
    - (ii) Components and subassemblies.
    - (iii) Simplified production methods.
    - (iv) Costs identified under cost-plus long-term contracts and federal long-term contracts.
    - (v) Interest.
      - (A) In general.
      - (B) Production period.
      - (C) Application of section 263A(f).
    - (vi) Research and experimental expenses.
    - (vii) Service costs.
      - (A) Simplified service cost method.
      - (1) In general.
      - (2) Example.
      - (B) Jobsite costs.
    - (C) Limitation on other reasonable cost allocation methods.
    - (c) Simplified cost-to-cost method for contracts subject to the PCM.
      - (1) In general.
      - (2) Election.
      - (d) Cost allocation rules for exempt construction contracts reported using CCM.
        - (1) In general.
        - (2) Indirect costs.
          - (i) Indirect costs allocable to exempt construction contracts.
          - (ii) Indirect costs not allocable to exempt construction contracts.

- (3) Large homebuilders.
- (e) Cost allocation rules for contracts subject to the PCCM.
- (f) Special rules applicable to costs allocated under this section.
  - (1) Nondeductible costs.
  - (2) Costs incurred for non-long-term contract activities.
  - (g) Method of accounting.

*§ 1.460-6 Look-back method.*

- (a) In general.
- (1) Introduction.
- (2) Overview.
- (b) Scope of look-back method.
  - (1) In general.
  - (2) Exceptions from section 460.
  - (3) De minimis exception.
  - (4) Alternative minimum tax.
  - (5) Effective date.
  - (c) Operation of the look-back method.
    - (1) Overview.
      - (i) In general.
      - (ii) Post-completion revenue and expenses.
        - (A) In general.
        - (B) Completion.
        - (C) Discounting of contract price and contract cost adjustments subsequent to completion; election not to discount.
          - (1) General rule.
          - (2) Election not to discount.
          - (3) Year-end discounting convention.
          - (D) Revenue acceleration rule.
            - (2) Look-back Step One.
              - (i) Hypothetical reallocation of income among prior tax years.
              - (ii) Treatment of estimated future costs in year of completion.
              - (iii) Interim reestimates not considered.
              - (iv) Tax years in which income is affected.
              - (v) Costs incurred prior to contract execution; 10-percent method.
                - (A) General rule.
                - (B) Example.
                - (vi) Amount treated as contract price.
                  - (A) General rule.
                  - (B) Contingencies.
                  - (C) Change orders.
                - (3) Look-back Step Two: Computation of hypothetical overpayment or underpayment of tax.
                  - (i) In general.
                  - (ii) Redetermination of tax liability.
                  - (iii) Hypothetical underpayment or overpayment.
                  - (iv) Cumulative determination of tax liability.
                  - (v) Years affected by look-back only.
                  - (vi) Definition of tax liability.
                - (4) Look-back Step Three: Calculation of interest on underpayment or overpayment.
                  - (i) In general.
                  - (ii) Changes in the amount of a loss or credit carryback or carryover.
                  - (iii) Changes in the amount of tax liability that generated a subsequent refund.
                  - (d) Simplified marginal impact method.

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- (1) Introduction.
- (2) Operation.
  - (i) In general.
  - (ii) Applicable tax rate.
  - (iii) Overpayment ceiling.
  - (iv) Example.
- (3) Anti-abuse rule.
- (4) Application.
  - (i) Required use by certain pass-through entities.
    - (A) General rule.
    - (B) Closely held.
    - (C) Examples.
    - (D) Domestic contracts.
    - (E) General rule.
    - (2) Portion of contract income sourced.
    - (E) Application to foreign contracts.
    - (F) Effective date.
      - (ii) Elective use.
        - (A) General rule.
        - (B) Election requirements.
        - (C) Consolidated group consistency rule.
      - (e) Delayed reapplication method.
        - (1) In general.
        - (2) Time and manner of making election.
        - (3) Examples.
        - (f) Look-back reporting.
          - (1) Procedure.
          - (2) Treatment of interest on return.
            - (i) General rule.
            - (ii) Timing of look-back interest.
          - (3) Statutes of limitations and compounding of interest on look-back interest.
            - (g) Mid-contract change in taxpayer.
              - (1) In general.
              - (2) Constructive completion transactions.
              - (3) Step-in-the-shoes transactions.
            - (i) General rules.
              - (ii) Application of look-back method to pre-transaction period.
                - (A) Contract price
                - (B) Method.
                - (C) Interest accrual period.
                - (D) Information old taxpayer must provide.
              - (E) In general.
                - (2) Special rules for certain pass-through entity transactions.
              - (iii) Application of look-back method to post-transaction years.
                - (iv) S corporation elections.
              - (4) Effective date.
            - (h) Examples.
              - (1) Overview.
              - (2) Step One.
              - (3) Step Two.
              - (4) Post-completion adjustments.
              - (5) Alternative minimum tax.
              - (6) Credit carryovers.
              - (7) Net operating losses.
              - (8) Alternative minimum tax credit.
              - (9) Period for interest.
              - (i) [Reserved]

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

[T.D. 9315, 55 FR 41670, Oct. 15, 1990, as amended by T.D. 8597, 60 FR 36683, July 18, 1995; T.D. 8756, 63 FR 1918, Jan. 13, 1998; T.D. 8775, 63 FR 36181, July 2, 1998; T.D. 8929, 66 FR 2224, Jan. 11, 2001; T.D. 8995, 67 FR 34605, May 15, 2002; T.D. 9137, 69 FR 42553, July 16, 2004]

### § 1.460-1 Long-term contracts.

(a) *Overview*—(1) *In general*. This section provides rules for determining whether a contract for the manufacture, building, installation, or construction of property is a long-term contract under section 460 and what activities must be accounted for as a single long-term contract. Specific rules for long-term manufacturing and construction contracts are provided in §§ 1.460-2 and 1.460-3, respectively. A taxpayer generally must determine the income from a long-term contract using the percentage-of-completion method described in § 1.460-4(b) (PCM) and the cost allocation rules described in § 1.460-5(b) or (c). In addition, after a contract subject to the PCM is completed, a taxpayer generally must apply the look-back method described in § 1.460-6 to determine the amount of interest owed on any hypothetical underpayment of tax, or earned on any hypothetical overpayment of tax, attributable to accounting for the long-term contract under the PCM.

(2) *Exceptions to required use of PCM*—(i) *Exempt construction contract*. The requirement to use the PCM does not apply to any exempt construction contract described in § 1.460-3(b). Thus, a taxpayer may determine the income from an exempt construction contract using any accounting method permitted by § 1.460-4(c) and, for contracts accounted for using the completed-contract method (CCM), any cost allocation method permitted by § 1.460-5(d). Exempt construction contracts that are not subject to the PCM or CCM are not subject to the cost allocation rules of § 1.460-5 except for the production-period interest rules of § 1.460-5(b)(2)(v). Exempt construction contractors that are large homebuilders described in § 1.460-5(d)(3) must capitalize costs under section 263A. All other exempt construction contractors must account for the cost of construction using the appropriate rules contained in other