Internal Revenue
bulletin

Bulletin No. 2001–10
March 5, 2001

HIGHLIGHTS OF THIS ISSUE

These synopses are intended only as aids to the reader in identifying the subject matter covered. They may not be relied upon as authoritative interpretations.

INCOME TAX

Rev. Rul. 2001–10, page 755.

Low-income housing credit; satisfactory bond; "bond factor" amounts for the period January through March 2001. This ruling announces the monthly bond factor amounts to be used by taxpayers who dispose of qualified low-income buildings or interests therein during the period January through March 2001.

Rev. Rul. 2001–11, page 780.

Insurance companies; interest rate tables. Prevailing state assumed interest rates are provided for the determination of reserves under section 807 of the Code for contracts issued in 2000 and 2001. Rev. Rul. 92–19 supplemented in part.

T.D. 8929, page 756.

Final regulations under section 460 of the Code provide guidance on accounting for long-term contracts.

Notice 2001–19, page 784.

Comments on research credit regulations. This notice announces that the Treasury Department and the IRS will review the research credit final regulations in T.D. 8930 (2001–5 I.R.B. 433), and that comments are requested on the final regulations. Upon completion of this review, Treasury and the IRS will announce changes to the regulations, if any, in the form of proposed regulations. In addition, T.D. 8930 will be revised so that the provisions of the regulations, including any changes, will be effective no earlier than the date the review is completed. However, the provisions related to internal-use computer software (including any revisions) generally will be applicable to taxable years beginning after December 31, 1985. Comments should be submitted by April 2, 2001.

Rev. Proc. 2001–23, page 784.

Dollar-value LIFO; used vehicles. This procedure provides an optional LIFO inventory computation method for taxpayers who sell used automobiles or used light-duty trucks. The link-chain, dollar-value LIFO inventory method is designed to simplify the dollar-value LIFO computations of used vehicle dealers. Rev. Proc. 99–49 modified and amplified.

Rev. Proc. 2001–24, page 788.

Change in method of accounting. This procedure allows an insurance company to obtain automatic consent to change its method of accounting for cash advances on commissions paid to its agents, from deducting cash advances in the taxable year paid to an agent to deducting cash advances in the taxable year earned by the agent. Rev. Proc. 99–49 modified and amplified.

Announcement 2001–23, page 791.

The Service announces supplements to Publication 575, *Pension and Annuity Income*, and Publication 590, *Individual Retirement Arrangements*, that take into account proposed regulations (REG–130477–00; REG–130481–00) substantially simplifying the calculation of minimum required distributions from qualified plans, IRAs, and other related retirement savings vehicles.

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Finding Lists begin on page ii.
Index for January and February begins on page iv.

Department of the Treasury
Internal Revenue Service

EMPLOYEE PLANS

Announcement 2001–18, page 791.

Model amendment; minimum distributions under section 401(a)(9). This announcement sets forth a corrected model amendment for qualified plan sponsors to adopt if they wish to follow the proposed regulations under section 401(a)(9) of the Code when making required minimum distributions for 2001 and subsequent calendar years.

Announcement 2001–23, page 791.

The Service announces supplements to Publication 575, *Pension and Annuity Income*, and Publication 590, *Individual Retirement Arrangements*, that take into account proposed regulations (REG–130477–00; REG–130481–00) substantially simplifying the calculation of minimum required distributions from qualified plans, IRAs, and other related retirement savings vehicles.

ADMINISTRATIVE

Announcement 2001–19, page 791.

This announcement corrects a numerical error in Rev. Rul. 2000–56, 2000–52 I.R.B. 597, relating to the inflation-adjusted amounts a taxpayer may lend a qualified continuing care facility without incurring imputed interest under section 7872(g) of the Code.

Announcement 2001–24, page 793.

Election to treat trust as part of an estate. This document changes the date of the public hearing and extends the time for submission of outlines of oral comments on proposed regulations REG–106542–98, 2001–5 I.R.B. 473. The hearing is scheduled for April 11, 2001. Comments must be received by March 21, 2001.

The IRS Mission

Provide America's taxpayers top quality service by helping them understand and meet their tax responsibilities and by applying the tax law with integrity and fairness to all.

Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest. It is published weekly and may be obtained from the Superintendent of Documents on a subscription basis. Bulletin contents are consolidated semiannually into Cumulative Bulletins, which are sold on a single-copy basis.

It is the policy of the Service to publish in the Bulletin all substantive rulings necessary to promote a uniform application of the tax laws, including all rulings that supersede, revoke, modify, or amend any of those previously published in the Bulletin. All published rulings apply retroactively unless otherwise indicated. Procedures relating solely to matters of internal management are not published; however, statements of internal practices and procedures that affect the rights and duties of taxpayers are published.

Revenue rulings represent the conclusions of the Service on the application of the law to the pivotal facts stated in the revenue ruling. In those based on positions taken in rulings to taxpayers or technical advice to Service field offices, identifying details and information of a confidential nature are deleted to prevent unwarranted invasions of privacy and to comply with statutory requirements.

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations, court decisions, rulings, and procedures must be considered, and Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The Bulletin is divided into four parts as follows:

Part I.—1986 Code.
This part includes rulings and decisions based on provisions of the Internal Revenue Code of 1986.

Part II.—Treaties and Tax Legislation.
This part is divided into two subparts as follows: Subpart A, Tax Conventions, and Subpart B, Legislation and Related Committee Reports.

Part III.—Administrative, Procedural, and Miscellaneous.
To the extent practicable, pertinent cross references to these subjects are contained in the other Parts and Subparts. Also included in this part are Bank Secrecy Act Administrative Rulings. Bank Secrecy Act Administrative Rulings are issued by the Department of the Treasury's Office of the Assistant Secretary (Enforcement).

Part IV.—Items of General Interest.
This part includes notices of proposed rulemakings, disbarment and suspension lists, and announcements.

The first Bulletin for each month includes a cumulative index for the matters published during the preceding months. These monthly indexes are cumulated on a semiannual basis, and are published in the first Bulletin of the succeeding semiannual period, respectively.

The contents of this publication are not copyrighted and may be reprinted freely. A citation of the Internal Revenue Bulletin as the source would be appropriate.

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Part I. Rulings and Decisions Under the Internal Revenue Code of 1986

Section 42.—Low-Income Housing Credit

Low-income housing credit; satisfactory bond; "bond factor" amounts for the period January through March 2001. This ruling announces the monthly bond factor amounts to be used by taxpayers who dispose of qualified low-income buildings or interests therein during the period January through March 2001.

Rev. Rul. 2001-10

In Rev. Rul. 90-60, 1990-2 C.B. 3, the Internal Revenue Service provided guidance to taxpayers concerning the general methodology used by the Treasury Department in computing the bond factor amounts used in calculating the amount of bond considered satisfactory by the Secretary under § 42(j)(6) of the Internal Revenue Code. It further announced that the Secretary would publish in the Internal Revenue Bulletin a table of "bond factor" amounts for dispositions occurring during each calendar month.

Rev. Proc. 99-11, 1999-1 C.B. 275, established a collateral program as an alternative to providing a surety bond for taxpayers to avoid or defer recapture of the low-income housing tax credits under § 42(j)(6). Under this program, taxpayers may establish a Treasury Direct Account and pledge certain United States Treasury securities to the Internal Revenue Service as security.

This revenue ruling provides in Table 1 the bond factor amounts for calculating the amount of bond considered satisfactory under § 42(j)(6) or the amount of United States Treasury securities to pledge in a Treasury Direct Account under Rev. Proc. 99-11 for dispositions of qualified low-income buildings or interests therein during the period January through March 2001.

Table 1
Rev. Rul. 2001-10
Monthly Bond Factor Amounts for Dispositions Expressed
As a Percentage of Total Credits

	Calendar Year Building Placed in Service or, if Section 42(f)(1) Election Was Made, the Succeeding Calendar Year										
Month of Disposition	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997
Jan '01	21.53	39.56	54.68	67.46	78.28	81.29	84.62	87.92	91.31	94.99	98.92
Feb '01	21.53	39.56	54.68	67.46	78.28	81.05	84.36	87.65	91.02	94.68	98.57
Mar '01	21.53	39.56	54.68	67.46	78.28	80.81	84.11	87.38	90.73	94.37	98.24

Table 1 (cont'd)
Rev. Rul. 2001-10
Monthly Bond Factor Amounts for Dispositions Expressed
As a Percentage of Total Credits

	Calendar Year Building Placed in Service or, if Section 42(f)(1) Election Was Made, the Succeeding Calendar Year			
Month of Disposition	1998	1999	2000	2001
Jan '01	103.25	107.67	111.85	112.52
Feb '01	102.87	107.22	111.28	112.52
Mar '01	102.50	106.80	110.79	112.52

For a list of bond factor amounts applicable to dispositions occurring during other calendar years, see the following revenue rulings: Rev. Rul. 98-3, 1998-1 C.B. 248; and Rev. Rul. 2001-2, 2001-2 I.R.B. 255.

DRAFTING INFORMATION

The principal author of this revenue ruling is Gregory N. Doran of the Office of Associate Chief Counsel (Passthroughs and Special Industries). For further information regarding this revenue ruling, contact Mr. Doran at (202) 622-3040 (not a toll-free call).

Section 446.—General Rule for Methods of Accounting

26 CFR 1.446–1: General rule for methods of accounting.

Optional dollar-value LIFO inventory computation method for used vehicle dealers. See Rev. Proc. 2001–23, page 784.

Section 451.—General Rule For Taxable Year of Inclusion

26 CFR 1.451–1: General rule for taxable year of inclusion.

Cash lent to agent by insurance company is incudible in taxable income when earned. See Rev. Proc. 2001–24, page 788.

Section 460.—Special Rules for Long-Term Contracts

26 CFR 1.460–0: Outline of regulations under section 460.

T.D. 8929

DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Parts 1 and 602

Accounting for Long-Term Contracts

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations describing how income from a long-term contract must be accounted for under section 460 of the Internal Revenue Code, which was enacted by the Tax Reform Act of 1986. A taxpayer manufacturing or constructing property under a long-term contract will be affected by these regulations.

DATES: *Effective Date*: These regulations are effective on January 11, 2001.

Applicability Date: These regulations apply to any contract entered into on or after January 11, 2001.

FOR FURTHER INFORMATION CONTACT: Leo F. Nolan II or John M. Aramburu of the Office of Associate Chief Counsel (Income Tax and Accounting) at (202) 622-4960 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in these final regulations has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)) under control number 1545–1650. Responses to this collection of information are mandatory.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number assigned by the Office of Management and Budget.

The estimated annual burden per respondent and/or recordkeeper is 15 minutes.

Comments concerning the accuracy of this burden estimate and suggestions for reducing this burden should be sent to the **Internal Revenue Service**, Attn: IRS Reports Clearance Officer, W:CAR:MP:FP:S:O, Washington, DC 20224, and to the **Office of Management and Budget**, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503.

Books or records relating to a collection of information must be retained as long as their contents might 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

Section 460, which was enacted by section 804 of the Tax Reform Act of 1986, Public Law 99–514 (100 Stat. 2085, 2358–2361), generally requires a taxpayer to determine the taxable income from a long-term contract using the percentage-of-completion method. Section 460 was amended by section 10203 of the Omnibus Budget Reconciliation Act of 1987, Public Law 100–203 (101 Stat. 1330, 1330–394); by sections 1008(c) and 5041 of the Technical and Miscellaneous Revenue Act of 1988, Public Law 100–647 (102 Stat. 3342, 3438–3439 and 3673–3676); by sections 7621 and 7811(e) of the Omnibus Budget Reconciliation Act of 1989, Public Law 101–239 (103 Stat. 2106, 2375–2377 and 2408–2409); by section 11812 of the Omnibus Budget Reconciliation Act of 1990, Public Law 101–508 (104 Stat. 1388, 1388–534 to 1388–536); by sections 1702(h)(15) and 1704(t)(28) of the Small Business Job Protection Act of 1996, Public Law 104–188 (110 Stat. 1755, 1874, 1888); and by section 1211 of the Taxpayer Relief Act of 1997, Public Law 105–34 (111 Stat. 788, 998–1000).

Section 460(h) directs the Secretary to prescribe regulations to the extent necessary or appropriate to carry out the purpose of section 460, including regulations to prevent a taxpayer from avoiding section 460 by using related parties, pass-through entities, intermediaries, options, and other similar arrangements.

On May 5, 1999, the IRS and Treasury Department published a notice of proposed rulemaking (REG–208156–91, 1999–1 C.B. 1141 [64 F.R. 24096]) relating to section 460. Comments responding to the notice were received, and a public hearing was scheduled for September 14, 1999.

The IRS and Treasury Department received eleven comment letters concerning the notice of proposed rulemaking. After considering the comments contained in these letters, the IRS and Treasury Department adopt the proposed regulations as revised by this Treasury decision. The comments and revisions are discussed below.

Explanation of Provisions

1. *Overview*

Section 460 generally requires the income from a long-term contract to be determined using the percentage-of-completion method based on a cost-to-cost comparison (PCM). However, the income from exempt construction contracts still may be determined using the completed-contract method (CCM), the exempt-contract percentage-of-completion method (EPCM), or any other permissible method. Contracts that are not long-term contracts must be accounted for using a permissible method of accounting other than a long-term contract method (i.e., a method other than the PCM, the CCM, or

the EPCM). See section 446 and the regulations thereunder.

One commentator suggested that the exceptions to the mandatory use of the PCM included in the proposed regulations be expanded to include "any portion of the long-term manufacturing contract for which no payment for the manufacture of the subject matter of the contract is required to be made before the manufacture of the item is completed." The exceptions contained in the proposed regulations were specifically provided by the statute and the statute does not include the suggestion made by the commentator. Thus, the IRS and Treasury Department did not adopt this suggestion.

2. *Definition of Long-Term Contract*

Under section 460(f), "long-term contract" generally means any contract for the building, installation, construction (construction), or the manufacture, of property if the contract is not completed within the taxable year the taxpayer enters into the contract (contracting year). However, a manufacturing contract is not a long-term contract unless it involves the manufacture of (1) a unique item of a type that is not normally included in the finished goods inventory of the taxpayer or (2) an item normally requiring more than 12 calendar months to complete, regardless of the duration of the contract.

Continuing the policy established in Notice 89–15 (1989–1 C.B. 634), the proposed regulations provide that it is not relevant whether the customer has title to, control over, or risk of loss with respect to the property. One commentator suggested that the final regulations should not retain the rule that requires a contractor to ignore title and risk-of-loss issues relative to the applicability of section 460 because a contractor has little freedom to restructure a contract to "construct" into a contract to "sell." The IRS and Treasury Department did not adopt this suggestion because we believe that a contract's classification should be based on the performance required of the taxpayer under the contract regardless of whether that contract otherwise would be classified as a sales contract or a construction or manufacturing contract. Moreover, the IRS and Treasury Department continue to believe that the rule in the proposed regulations is necessary to prevent a taxpayer from circumventing section 460 by structuring a construction contract to resemble a sales contract without changing the taxpayer's obligations under the contract. Another commentator asked whether a contract is subject to section 460 if it requires the taxpayer to manufacture or construct property in order to fulfill its contractual obligation but the property is never delivered to the customer (e.g., a research contract for test results). Again, the IRS and Treasury Department believe that a contract's classification should depend upon the performance required of the taxpayer under the contract. Thus, the final regulations clarify that it is irrelevant whether title in the property manufactured or constructed under the contract is delivered to the customer.

The proposed regulations provide that a contract is not a construction contract if it requires the taxpayer to provide land to the customer and the estimated total allocable contract costs attributable to the taxpayer's construction activities are less than 10 percent of the contract's total contract price. One commentator asked for clarification concerning whether the estimated total allocable contract costs attributable to the taxpayer's construction activities includes the cost of the land provided under the contract. The final regulations clarify that the cost of this land is not an allocable contract cost when the taxpayer determines whether the cost of its construction activities is less than 10 percent of the contract's total contract price.

3. *Date Taxpayer Completes a Long-Term Contract*

The proposed regulations provide that a long-term contract is completed in the earlier taxable year (completion year) that: (1) the customer uses the subject matter of the contract (other than for testing) and at least 95 percent of the total allocable contract costs attributable to the subject matter have been incurred by the taxpayer; or (2) the subject matter of the contract is finally completed and accepted. To the extent that the "customer-use" rule requires a taxpayer to treat a contract as completed before final completion and acceptance have occurred, the proposed regulations explicitly adopt a rule different from that considered in *Ball, Ball and Brosamer, Inc. v. Commissioner*, 964 F.2d 890 (9th Cir. 1992), *aff'g* T.C. Memo. 1990–454.

Some commentators argued against having a rule that will declare a contract completed earlier than under the finally-completed-and-accepted standard illustrated in *Ball*. Some commentators also argued that the customer-use rule is confusing to subcontractors because it is unclear whether a subcontractor's "customer" is the general, or "prime," contractor or the ultimate owner of the property. On the other hand, one commentator asked for a bright-line standard for completion and suggested, among other possibilities, that completion occur when 95 percent of the estimated costs have been incurred.

The IRS and Treasury Department continue to believe that a contract is complete for all practical purposes when the customer uses the subject matter of that contract and the taxpayer has only five percent or less of the total allocable contract costs remaining to be incurred. Delaying a contract's completion beyond this point, as the Tax Court permitted in *Ball*, does not reflect the substance of the transaction and could encourage the use of formalities to delay a contract's completion unreasonably. Thus, the final regulations do not substantively change the customer-use rule contained in the proposed regulations. However, the final regulations clarify that a subcontractor's customer is the general contractor.

Several commentators expressed concern that the customer-use rule contained in the proposed regulations will create additional administrative burdens for taxpayers using the PCM because they often will have to apply the look-back method two times, first upon customer use and again upon final completion and acceptance. Though the IRS and Treasury Department believe that the customer-use rule results in an appropriate determination of completion, we understand these concerns. Thus, to simplify a taxpayer's reporting requirements under the look-back method, the IRS and Treasury Department have modified the look-back regulations to require a taxpayer to delay the first application of the look-back method until the taxable year in which a

long-term contract is finally completed and accepted.

4. *Severing and Aggregating Contracts*

The proposed regulations allow the Commissioner, and generally require a taxpayer, to sever and aggregate contracts when necessary to clearly reflect income. The proposed regulations provide the following criteria for determining whether severance or aggregation is required: independent versus interdependent pricing, separate delivery or acceptance, and the reasonable businessperson standard. However, under the proposed regulations, a taxpayer may not sever a contract subject to the PCM. In addition, the proposed regulations require a taxpayer to notify the Commissioner when severing a long-term contract not accounted for using the PCM and provide agreement-specific information, including the criteria for severing or aggregating the agreement.

Some commentators criticized the "no severance" rule for long-term contracts subject to the PCM. The "no severance" rule is provided in the proposed regulations because the IRS and Treasury Department believe that in most cases, a taxpayer's use of the PCM and look-back method will clearly reflect the taxpayer's income from a long-term contract. To date, the only identified reason to allow severance of a contract subject to the PCM related to the application of the 10-percent method as shown in §1.460-1(j) *Example 8* of the proposed income tax regulations. Conversely, the IRS and Treasury Department believe that permitting a taxpayer to sever a contract subject to the PCM could allow the taxpayer to manipulate taxable income (e.g., by severing to create a loss contract and accelerate the loss) or to avoid the application of section 460 (e.g., by "completing" the contract during the contracting year). Nonetheless, the IRS and Treasury Department agree with the commentators' concerns that to the extent severance is necessary to clearly reflect income from a long-term contract (e.g., due to the application of the 10-percent method), it should be permitted. Accordingly, the final regulations allow a taxpayer to sever a long-term contract if necessary to clearly reflect income, but only if the taxpayer has obtained the Commissioner's prior written consent.

Some commentators criticized the notification requirement for severed and aggregated contracts as being unduly burdensome. The IRS and Treasury Department continue to believe that notification will help taxpayers and the IRS consistently apply the severing and aggregating rules. In recognition of the potential burden associated with the proposed notification requirement, however, the final regulations simplify the notification by only requiring that a taxpayer inform the IRS when it has severed or aggregated agreements. Thus, the taxpayer is no longer required to provide agreement-specific information.

One commentator suggested that the reasonable businessperson standard be eliminated because it is merely a subset of independent pricing and interdependent pricing (the pricing standards), which should be the primary criteria for determining whether long-term contracts must be severed or aggregated to clearly reflect income. The IRS and Treasury Department agree that the pricing standards and the reasonable businessperson standard overlap, but believe that the pricing standard is a subset of the reasonable businessperson standard. Besides requiring an analysis of pricing, the reasonable businessperson standard requires an analysis of all the facts and circumstances of the business arrangement between the taxpayer and the customer. Thus, because the absence of the reasonable businessperson standard might change the decision to sever or aggregate in some cases, the final regulations retain this criterion and clarify its distinction from the pricing standards.

5. *Hybrid Contracts*

Under the proposed regulations, a taxpayer generally must classify a contract that requires the taxpayer to manufacture personal property and to construct real property (hybrid contract) as separate manufacturing and construction contracts. If at least 95 percent of the estimated allocable contract costs are reasonably allocable to manufacturing (or construction) activities, the taxpayer may classify the contract as a manufacturing (or construction) contract.

One commentator suggested that the final regulations allow a taxpayer to elect to use the PCM to account for a hybrid contract instead of requiring the taxpayer to account for both parts separately. The IRS and Treasury Department agree with the commentator's request for simplification. Accordingly, the final regulations allow a taxpayer to elect, on a contract-by-contract basis, to classify a hybrid contract as a long-term manufacturing contract subject to the PCM. In addition, because this election effectively supersedes the 95-percent election that would have applied to hybrid contracts that are primarily manufacturing contracts, the final regulations retain the 95-percent election as a second election that applies only to hybrid contracts that are primarily construction contracts.

6. *Contracts of Related Parties*

The proposed regulations provide that if a related party and its customer enter into a long-term contract subject to the PCM, and a taxpayer performs any activity that is incident to or necessary for the related party's long-term contract, the taxpayer must account for the gross receipts and costs attributable to the activity using the PCM. However, the proposed regulations contain an inventory exception for components and subassemblies produced by the taxpayer if the taxpayer regularly carries these items in its finished goods inventories and 80 percent or more of the gross receipts from the sale of these items typically comes from unrelated parties.

One commentator suggested that the percentage threshold be lowered from 80 percent to 50 percent and that the exception not be limited to items regularly carried in the taxpayer's finished goods inventories. The IRS and Treasury Department included the related party rule, originally promulgated in Notice 89-15, in the proposed regulations to prevent taxpayers from establishing special-purpose subsidiaries to avoid the application of section 460. However, in recognition that a related party that sells most units of a manufactured item to unrelated parties was not established for the purpose of avoiding section 460, the IRS and Treasury Department added the inventory exception to the proposed regulations to reduce the related party's accounting burden. The IRS and Treasury Department agree, however, that the inventory exception is too narrow. Accordingly, the final regulations lower the percentage threshold from "80 percent or more" to "more

than 50 percent" and eliminate the requirement that the components or subassemblies be carried in finished goods inventories.

7. *Unique Items*

Section 460 applies if a taxpayer manufactures a unique item of a type that is not normally included in the finished goods inventory of the taxpayer and if the contract is not completed by the close of the contracting year. The proposed regulations provide that "unique" means specifically designed for the needs of a customer. In addition, the proposed regulations contain three safe harbors concerning contracts to manufacture unique items. First, an item is not unique if the taxpayer normally completes the item within 90 days. Second, an item is not unique if the total allocable contract costs attributable to customizing activities that are incident to or necessary for the production of the item do not exceed 5 percent of the estimated total costs allocable to the item. Third, a unique item ceases to be unique no later than when the taxpayer normally includes similar items in its finished goods inventory. For an item that does not satisfy one of these three safe harbors, the determination of whether the item is unique is based on the facts and circumstances.

Some commentators suggested that the final regulations contain either a 140-day or a 180-day safe harbor instead of the 90-day safe harbor. The IRS and Treasury Department did not adopt these suggestions because we believe that a 90-day safe harbor appropriately limits the meaning of "unique" in most cases. However, the IRS and Treasury Department have modified the 90-day safe harbor to clarify that in the case of a contract to manufacture multiple units of the same item, the 90-day safe harbor applies only if each unit normally is completed within 90 days.

Some commentators suggested that the final regulations contain either a 10-percent, 15-percent, or 20-percent safe harbor instead of the 5-percent safe harbor. In particular, these commentators stated that a 5-percent safe harbor will not alleviate any controversy between taxpayers and revenue agents because revenue agents generally do not raise the issue of unique items if the taxpayer's customizing costs do not exceed 5 percent. The IRS and Treasury Department agree that it is reasonable to assume that an item is not unique if the taxpayer's customizing costs do not exceed 10 percent. Thus, the customization safe harbor in the final regulations has been increased to 10 percent.

One commentator suggested that the cost of a taxpayer's customizing activities should not include the cost of any customized equipment purchased by a taxpayer from an unrelated party under a "special accommodation" arrangement with the customer that requires the taxpayer to acquire and install that customized equipment. The IRS and Treasury Department did not adopt this suggestion because such a special accommodation rule could enable taxpayers to avoid section 460 by having some long-term contract activities performed by outside parties.

Several commentators questioned the relevance of the "basic design" concept included in §1.460-2(e) *Example 1* of the proposed regulations. To determine whether an item is unique, the relevant analysis is whether an item is customized (or manufactured according to a customer's specifications) regardless of whether the item is customized from a basic design. Accordingly, the final regulations delete the reference to the taxpayer's basic design in the example to eliminate any confusion.

One commentator questioned how the safe harbor applies in the case of a contract to manufacture multiple units of the same item. The IRS and Treasury Department believe that if significant customization is necessary to produce an item for a customer under the contract, that item is specifically designed for the needs of the customer, and thus is a unique item, regardless of the number of units produced for the customer under the contract. Thus, the final regulations clarify that for the purposes of applying the 10-percent safe harbor to a contract to manufacture multiple units of the same item, a taxpayer must allocate all customization costs to the first unit manufactured under the contract.

Some commentators suggested the addition of a fourth safe harbor that would exclude "income on contracts for which progress payments have not been received by year end." The IRS and Treasury Department did not adopt this suggestion because we do not believe that such a rule bears any relationship to a determination of the uniqueness of an item and because such a rule is inconsistent with the statute.

8. *12-Month Completion Period*

The proposed regulations provide that a manufactured item normally requires more than 12 months to complete if its "production period," as defined in §1.263A-12, is reasonably expected to exceed 12 months, determined at the end of the contracting year. In general, the production period for an item or unit begins when the taxpayer incurs at least 5 percent of the estimated total allocable contract costs, including planning and design expenditures, allocable to the item or unit, and the production period ends when the item or unit is ready for shipment to the taxpayer's customer.

Some commentators suggested that the final regulations be clarified to provide that "normal time to complete" includes only the time of physical production activity and not the time of any research, development, planning, or design activity. The IRS and Treasury Department did not adopt this suggestion because we believe that the definition of "production period" under §1.263A-12(c)(3), which includes the time required for planning and design activity, is consistent with the allocation of costs to extended-period long-term contracts under §1.451-3(d)(6) and with section 460(c)(1), which requires that costs be allocated under the rules applicable to extended-period long-term contracts. In addition, if an item manufactured under a long-term contract requires a significant amount of design time to produce, it is appropriate to include the time needed to perform these activities when determining that item's "normal time to complete" because these activities are directly attributable to that contract and are necessary to manufacture the subject matter of the contract. However, the final regulations clarify that a taxpayer is not required to consider activities related to costs that are not allocable contract costs under section 460 (e.g., independent research and development expenses, marketing expenses) when determining the item's normal time to complete.

Some commentators asked how the 12-month rule applies in the case of a contract to manufacture multiple units of the same item. The final regulations clarify, that for the purposes of applying the 12-month rule to this type of contract, the time required to design and manufacture the first unit generally does not reflect the item's "normal time to complete." For example, the time required to design the first unit of an item should not be considered as time required to manufacture subsequent identical units. The final regulations also include an example illustrating the determination of normal time to complete an item in the case of a contract to manufacture multiple units of the same item.

9. *Percentage-of-Completion Method*

The proposed regulations provide that, under the PCM, a taxpayer generally includes a portion of the total contract price in income for each taxable year that the taxpayer incurs contract costs allocable to the long-term contract. Under the proposed regulations, total contract price included all bonuses, awards, and incentive payments if it is reasonably estimated that they will be received, even if the all events test has not yet been met. If, by the end of the completion year, a taxpayer cannot reasonably estimate whether a contingency will be satisfied, the bonus, award, or incentive payment is not includible in total contract price.

Some commentators argued that a taxpayer should not have to include contingent compensation in "total contract price" until the all events test for the item has been satisfied. The IRS and Treasury Department did not adopt this suggestion because the all events test is a judicially created test applying to taxpayers using an accrual method. *U.S. v. Anderson*, 269 U.S. 422 (1926). Conversely, section 460 is a self-contained, statutorily created accounting method that requires taxpayers to use estimated amounts when computing taxable income under the PCM and to use actual amounts when applying the look-back method. In addition, using the most accurate estimate of total contract price and total contract costs will produce the most accurate annual reporting of income and costs and will minimize discrepancies that could necessitate paying look-back interest. See *Tutor-Saliba Corp. v. Commissioner*, 115 T.C. No. 1 (July 17, 2000). However, in response to comments and questions concerning the contingent income rule, the final regulations provide that contingent income is includible in total contract price not later than when it is included in income for financial reporting purposes under generally accepted accounting principles.

One commentator suggested that the final regulations incorporate the rule under §1.451–3(a)(1) that allows a taxpayer to account for long-term contracts of less-than-substantial duration using a method of accounting other than a long-term contract method of accounting. The IRS and Treasury Department did not adopt this suggestion because such a rule would be inconsistent with the statutory definition of "long-term contract."

One commentator asked how a contractor should account for the subject matter of a long-term contract when the customer breaches that contract before the contractor has transferred title to the customer but after the contractor has reported taxable income from that contract under the PCM (e.g., unfinished condominium unit). In response to this comment, the final regulations include new §1.460–4(b)(7), which provides that if a long-term contract is terminated before completion and, as a result, the taxpayer retains ownership of the property that is the subject matter of that contract, the taxpayer must reverse the previously reported gross income (loss) from the transaction in the taxable year of termination. As a result of reversing its previously reported gross income under this rule, a taxpayer generally will have an adjusted basis in the retained property equal to its previously deducted allocable contract costs. The look-back method does not apply to any terminated contract to the extent it is subject to this rule. The IRS and Treasury Department request suggestions for rules that will apply when the customer acquires ownership of some, but not all, of the property that is the subject matter of the contract.

10. *Cost Allocation Rules*

The proposed and final regulations provide that a taxpayer generally must allocate costs to a contract subject to section 460(a) in the same manner as direct and indirect costs are capitalized to property produced by a taxpayer under section 263A. The regulations provide exceptions, however, that reflect the differences in the cost allocation rules of sections 263A and 460.

One commentator argued that the final regulations should contain a single standard for determining when the cost of a direct material is allocable to a long-term contract. In response to this comment, the final regulations contain a single standard linked to the uniform capitalization (UNICAP) rules of section 263A. The final regulations also clarify that, among other methods, a taxpayer dedicates direct materials by associating them with a specific contract (e.g., by purchase order, entry on books and records, shipping instructions).

One commentator suggested that the final regulations clarify that taxpayers should not treat software development and software implementation costs as customization costs for the purposes of the proposed 5-percent safe harbor. The IRS and Treasury Department did not adopt this suggestion because we believe that software costs are allocable contract costs (and thus customization costs) to the extent they are incident to or necessary for the manufacture of the subject matter of the contract.

This commentator also suggested that the final regulations clarify that taxpayers should not treat guarantee, warranty, and maintenance costs as customization costs for the purposes of the proposed 5-percent safe harbor. The IRS and Treasury Department modified §1.460–1(d)(2) to clarify that these types of costs are not allocable contract costs.

11. *Simplified Cost-To-Cost Method*

The proposed regulations generally permit a taxpayer to elect to allocate contract costs using the simplified cost-to-cost method. Under the simplified cost-to-cost method, a taxpayer must determine a contract's completion factor based upon only direct material costs; direct labor costs; and depreciation, amortization, and cost recovery allowances on equipment and facilities directly used to manufacture or construct property under the contract.

One commentator suggested that the final regulations clarify whether a taxpayer using the simplified cost-to-cost method is allowed or required to include

subcontracted costs in a contract's completion factor. In response to this comment, the final regulations clarify that subcontracted costs represent either direct material or direct labor costs and thus must be allocated to a contract under the simplified cost-to-cost method when incurred under § 1.461–4(d)(2)(ii). In addition, a taxpayer must allocate subcontracted costs for all section 460 purposes (e.g., applying the 10-percent safe harbor under §1.460–2(b)(2)(ii)).

12. *Statute of Limitations and Compound Interest on Look-Back Interest*

One commentator requested guidance concerning the statute of limitations applicable to payments of, and claims for, look-back interest. The final regulations amend §1.460–6(f)(1) and (2) to clarify the reporting requirements and add new §1.460–6(f)(3). New §1.460–6(f)(3) provides guidance on the statute of limitations applicable to the assessment and collection of look-back interest owed by a taxpayer. In addition, new §1.460–6(f)(3) provides that a taxpayer's claim for credit or refund of look-back interest previously paid by or collected from the taxpayer is a claim for credit or refund of an overpayment of tax for federal income tax purposes, which is subject to the section 6511 statute of limitations. In contrast, new §1.460–6(f)(3) provides that a taxpayer's claim for look-back interest (or interest payable on look-back interest) that is not attributable to an amount previously paid by or collected from the taxpayer is a general claim against the federal government, which is subject to the statutes of limitations found in 28 U.S.C. sections 2401 and 2501.

13. *Effective Date*

These final regulations apply to any contract entered into on or after January 11, 2001.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. Pursuant to section 7805(f) of the Internal Revenue Code, this Treasury decision was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business. It is hereby certified that the collection of information in this Treasury decision will not have a significant economic impact on a substantial number of small entities. The regulations require a taxpayer to attach a statement to its original federal income tax return if the taxpayer severs or aggregates a long-term contract. The statement is needed so the Commissioner can determine whether the taxpayer properly severed or aggregated the contract. It is uncommon for a taxpayer that has a long-term contract to sever or aggregate that contract. In addition, if a contract is severed or aggregated and a statement is required, it is estimated that it will, on average, require only 15 minutes to complete.

Drafting Information

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

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Adoption of Amendments to the Regulations

Accordingly, 26 CFR parts 1 and 602 are amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation is amended by removing the entry for "Section 1.451–3 and 1.451–5", revising the entry for "Section 1.460–4", and adding the following entries in numerical order to read as follows:

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

Section 1.451–5 also issued under 96 Stat. 324, 493.***

Section 1.460–1 also issued under 26 U.S.C. 460(h).

Section 1.460–2 also issued under 26 U.S.C. 460(h).

Section 1.460–3 also issued under 26 U.S.C. 460(h).

Section 1.460–4 also issued under 26 U.S.C. 460(h) and 1502.

Section 1.460–5 also issued under 26 U.S.C. 460(h). * * *

§1.446–1 [Amended]

Par. 2. Section 1.446–1 is amended as follows:

1. In the second sentence of paragraph (c)(1)(iii), the language "451" is removed and "460" is added in its place.

2. In the fourth sentence of paragraph (e)(2)(ii)(*a*), the language "§1.451–3" is removed and "§1.460–4" is added in its place.

§1.451–3 [Removed]

Par. 3. Section 1.451–3 is removed.

§1.451–5 [Amended]

Par. 4. Section 1.451–5 is amended by removing the language "§1.451–3" and adding "§1.460–4" in its place in the first sentence of paragraph (b)(3).

Par. 5. Section 1.460–0 is amended by:

1. Revising the introductory text.

2. Revising the entries for §§1.460–1 through 1.460–3, 1.460–4(a) through (i), and 1.460–5.

3. Adding an entry for §1.460–4(k).

4. Removing the entry for §1.460–6(c)(4)(iv).

5. Adding an entry for §1.460–6(f)(3).

6. Removing the entries for §§1.460–7 and 1.460–8.

The revisions and addition read as follows:

§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.
(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 subassemblies.
(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.
(f) Alternative minimum taxable income.
(1) In general.
(2) Election to use regular completion factors.
(g) Method of accounting.
(h) Examples.
(i) [Reserved].
* * * * *
(k) Mid-contract change in taxpayer [Reserved].

§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.

* * * * *
(f) * * *
(3) Statutes of limitations and compounding of interest on look-back interest.
* * * * *

Par. 6. Sections 1.460–1 through 1.460–3 are revised to read as follows:

§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 sections of the Internal Revenue Code or regulations.

(ii) *Qualified ship or residential construction contract*. The requirement to use the PCM applies only to a portion of a *qualified ship contract* described in §1.460–2(d) or *residential construction contract* described in §1.460–3(c). A taxpayer generally may determine the income from a qualified ship contract or residential construction contract using the percentage-of-completion/capitalized-cost method (PCCM) described in §1.460–4(e), but must use a cost allocation method described in §1.460–5(b) for the entire contract.

(b) *Terms*—(1) *Long-term contract*. A *long-term contract* generally is any contract for the manufacture, building, installation, or construction of property if the contract is not completed within the contracting year, as defined in paragraph (b)(5) of this section. However, a contract for the manufacture of property is a long-term contract only if it also satisfies either the unique item or 12-month requirements described in §1.460–2. A contract for the manufacture of personal property is a *manufacturing contract*. In contrast, a contract for the building, installation, or construction of real property is a *construction contract*.

(2) *Contract for the manufacture, building, installation, or construction of property*—(i) *In general*. A contract is a *contract for the manufacture, building, installation, or construction of property* if the manufacture, building, installation, or construction of property is necessary for the taxpayer's contractual obligations to be fulfilled and if the manufacture, building, installation, or construction of that property has not been completed when the parties enter into the contract. If a taxpayer has to manufacture or construct an item to fulfill its obligations under the contract, the fact that the taxpayer is not required to deliver that item to the customer is not relevant. Whether the customer has title to, control over, or bears the risk of loss from, the property manufactured or constructed by the taxpayer also is not relevant. Furthermore, how the parties characterize their agreement (e.g., as a contract for the sale of property) is not relevant.

(ii) *De minimis construction activities*. Notwithstanding paragraph (b)(2)(i) of this section, a contract is not a construction contract under section 460 if the contract includes the provision of land by the taxpayer and the estimated total allocable contract costs, as defined in paragraph (b)(3) of this section, attributable to the taxpayer's construction activities are less than 10 percent of the contract's total contract price, as defined in §1.460–4(b)(4)(i). For the purposes of this paragraph (b)(2)(ii), the allocable contract costs attributable to the taxpayer's construction activities do not include the cost of the land provided to the customer. In addition, a contract's estimated total allocable contract costs include a proportionate share of the estimated cost of any common improvement that benefits the subject matter of the contract if the taxpayer is contractually obligated, or required by law, to construct the common improvement.

(3) *Allocable contract costs*. *Allocable contract costs* are costs that are allocable to a long-term contract under §1.460–5.

(4) *Related party*. A *related party* is a person whose relationship to a taxpayer is described in section 707(b) or 267(b), determined without regard to section 267(f)(1)(A) and determined by replacing "at least 80 percent" with "more than 50 percent" for the purposes of determining the ownership of the stock of a corporation in sections 267(b)(2), (8), (10)(A), and (12).

(5) *Contracting year*. The *contracting year* is the taxable year in which a taxpayer enters into a contract as described in paragraph (c)(2) of this section.

(6) *Completion year*. The *completion year* is the taxable year in which a taxpayer completes a contract as described in paragraph (c)(3) of this section.

(7) *Contract commencement date*. The *contract commencement date* is the date that a taxpayer or related party first incurs any allocable contract costs, such as design and engineering costs, other than expenses attributable to bidding and negotiating activities. Generally, the contract commencement date is relevant in applying §1.460–6(b)(3) (concerning the *de minimis* exception to the look-back method under section 460(b)(3)(B)); §1.460–5(b)(2)(v)(B)(*1*)(*i*) (concerning the production period subject to interest allocation); §1.460–2(d) (concerning qualified ship contracts); and §1.460–3(b)(1)(ii) (concerning the construction period for exempt construction contracts).

(8) *Incurred*. *Incurred* has the meaning given in §1.461–1(a)(2) (concerning the taxable year a liability is incurred under the accrual method of accounting), regardless of a taxpayer's overall method of accounting. See §1.461–4(d)(2)(ii) for economic performance rules concerning the PCM.

(9) *Independent research and development expenses*. *Independent research and development expenses* are any expenses incurred in the performance of research or development, except that this term does not include any expenses that are directly attributable to a particular long-term contract in existence when the expenses are incurred and this term does not include any expenses under an agreement to perform research or development.

(10) *Long-term contract methods of accounting*. *Long-term contract methods of accounting*, which include the PCM, the CCM, the PCCM, and the exempt-contract percentage-of-completion method (EPCM), are methods of accounting that may be used only for long-term contracts.

(c) *Entering into and completing long-term contracts*—(1) *In general*. To determine when a contract is entered into under paragraph (c)(2) of this section and completed under paragraph (c)(3) of this section, a taxpayer must consider all relevant allocable contract costs incurred and activities performed by itself, by related parties on its behalf, and by the customer, that are incident to or necessary for the long-term contract. In addition, to determine whether a contract is completed in the contracting year, the taxpayer may not consider when it expects to complete the contract.

(2) *Date contract entered into*—(i) *In general*. A taxpayer enters into a contract on the date that the contract binds both the taxpayer and the customer under applicable law, even if the contract is subject to unsatisfied conditions not within the taxpayer's control (such as obtaining financing). If a taxpayer delays entering into a contract for a principal purpose of avoiding section 460, however, the taxpayer will be treated as having entered into a contract not later than the contract commencement date.

(ii) *Options and change orders*. A taxpayer enters into a new contract on the date that the customer exercises an option or similar provision in a contract if that option or similar provision must be severed from the contract under paragraph (e) of this section. Similarly, a taxpayer enters into a new contract on the date that it accepts a change order or other similar agreement if the change order or other similar agreement must be severed from the contract under paragraph (e) of this section.

(3) *Date contract completed*—(i) *In general*. A taxpayer's contract is completed upon the earlier of—

(A) Use of the subject matter of the contract by the customer for its intended purpose (other than for testing) and at least 95 percent of the total allocable contract costs attributable to the subject matter have been incurred by the taxpayer; or

(B) Final completion and acceptance of the subject matter of the contract.

(ii) *Secondary items*. The date a contract accounted for using the CCM is completed is determined without regard to whether one or more secondary items have been used or finally completed and accepted. If any secondary items are incomplete at the end of the taxable year in which the primary subject matter of a contract is completed, the taxpayer must separate the portion of the gross contract price and the allocable contract costs attributable to the incomplete secondary item(s) from the completed contract and account for them using a permissible method of accounting. A permissible method of accounting includes a long-term contract method of accounting only if a separate contract for the secondary item(s) would be a long-term contract, as defined in paragraph (b)(1) of this section.

(iii) *Subcontracts*. In the case of a subcontract, a subcontractor's customer is the general contractor. Thus, the subject matter of the subcontract is the relevant subject matter under paragraph (c)(3)(i) of this section.

(iv) *Final completion and acceptance*—(A) *In general*. Except as otherwise provided in this paragraph (c)(3)(iv), to determine whether final completion and acceptance of the subject matter of a contract have occurred, a taxpayer must consider all relevant facts and circumstances. Nevertheless, a taxpayer may not delay the completion of a contract for the principal purpose of deferring federal income tax.

(B) *Contingent compensation*. Final completion and acceptance is determined without regard to any contractual term that provides for additional compensation that is contingent on the successful performance of the subject matter of the contract. A taxpayer must account for all contingent compensation that is not includible in total contract price under §1.460–4(b)(4)(i), or in gross contract price under §1.460–4(d)(3), using a permissible method of accounting. For application of the look-back method for contracts accounted for using the PCM, see §1.460–6(c)(1)(ii) and (2)(vi).

(C) *Assembly or installation*. Final completion and acceptance is determined without regard to whether the taxpayer has an obligation to assist or supervise assembly or installation of the subject matter of the contract where the assembly or installation is not performed by the taxpayer or a related party. A taxpayer must account for the gross receipts and costs attributable to such an obligation using a permissible method of accounting, other than a long-term contract method.

(D) *Disputes*. Final completion and acceptance is determined without regard to whether a dispute exists at the time the taxpayer tenders the subject matter of the contract to the customer. For contracts

accounted for using the CCM, see §1.460–4(d)(4). For application of the look-back method for contracts accounted for using the PCM, see §1.460–6(c)(1)(ii) and (2)(vi).

(d) *Allocation among activities*—(1) *In general*. Long-term contract methods of accounting apply only to the gross receipts and costs attributable to long-term contract activities. Gross receipts and costs attributable to long-term contract activities means amounts included in total contract price or gross contract price, whichever is applicable, as determined under §1.460–4, and costs allocable to the contract, as determined under §1.460–5. Gross receipts and costs attributable to non-long-term contract activities (as defined in paragraph (d)(2) of this section) generally must be taken into account using a permissible method of accounting other than a long-term contract method. See section 446(c) and §1.446–1(c). However, if the performance of a non-long-term contract activity is incident to or necessary for the manufacture, building, installation, or construction of the subject matter of one or more of the taxpayer's long-term contracts, the gross receipts and costs attributable to that activity must be allocated to the long-term contract(s) benefitted as provided in §§1.460–4(b)(4)(i) and 1.460–5(f)(2), respectively. Similarly, if a single long-term contract requires a taxpayer to perform a non-long-term contract activity that is not incident to or necessary for the manufacture, building, installation, or construction of the subject matter of the long-term contract, the gross receipts and costs attributable to that non-long-term contract activity must be separated from the contract and accounted for using a permissible method of accounting other than a long-term contract method. But see paragraph (g) of this section for related party rules.

(2) *Non-long-term contract activity. Non-long-term contract activity* means the performance of an activity other than manufacturing, building, installation, or construction, such as the provision of architectural, design, engineering, and construction management services, and the development or implementation of computer software. In addition, performance under a guaranty, warranty, or maintenance agreement is a non-long-term contract activity that is never incident to or necessary for the manufacture or construction of property under a long-term contract.

(e) *Severing and aggregating contracts*—(1) *In general*. After application of the allocation rules of paragraph (d) of this section, the severing and aggregating rules of this paragraph (e) may be applied by the Commissioner or the taxpayer as necessary to clearly reflect income (e.g., to prevent the unreasonable deferral (or acceleration) of income or the premature recognition (or deferral) of loss). Under the severing and aggregating rules, one agreement may be treated as two or more contracts, and two or more agreements may be treated as one contract. Except as provided in paragraph (e)(3)(ii) of this section, a taxpayer must determine whether to sever an agreement or to aggregate two or more agreements based on the facts and circumstances known at the end of the contracting year.

(2) *Facts and circumstances*. Whether an agreement should be severed, or two or more agreements should be aggregated, depends on the following factors:

(i) *Pricing*. Independent pricing of items in an agreement is necessary for the agreement to be severed into two or more contracts. In the case of an agreement for similar items, if the price to be paid for the items is determined under different terms or formulas (e.g., if some items are priced under a cost-plus incentive fee arrangement and later items are to be priced under a fixed-price arrangement), then the difference in the pricing terms or formulas indicates that the items are independently priced. Similarly, interdependent pricing of items in separate agreements is necessary for two or more agreements to be aggregated into one contract. A single price negotiation for similar items ordered under one or more agreements indicates that the items are interdependently priced.

(ii) *Separate delivery or acceptance*. An agreement may not be severed into two or more contracts unless it provides for separate delivery or separate acceptance of items that are the subject matter of the agreement. However, the separate delivery or separate acceptance of items by itself does not necessarily require an agreement to be severed.

(iii) *Reasonable businessperson*. Two or more agreements to perform manufacturing or construction activities may not be aggregated into one contract unless a reasonable businessperson would not have entered into one of the agreements for the terms agreed upon without also entering into the other agreement(s). Similarly, an agreement to perform manufacturing or construction activities may not be severed into two or more contracts if a reasonable businessperson would not have entered into separate agreements containing terms allocable to each severed contract. Analyzing the reasonable businessperson standard requires an analysis of all the facts and circumstances of the business arrangement between the taxpayer and the customer. For purposes of this paragraph (e)(2)(iii), a taxpayer's expectation that the parties would enter into another agreement, when agreeing to the terms contained in the first agreement, is not relevant.

(3) *Exceptions*—(i) *Severance for PCM*. A taxpayer may not sever under this paragraph (e) a long-term contract that would be subject to the PCM without obtaining the Commissioner's prior written consent.

(ii) *Options and change orders*. Except as provided in paragraph (e)(3)(i) of this section, a taxpayer must sever an agreement that increases the number of units to be supplied to the customer, such as through the exercise of an option or the acceptance of a change order, if the agreement provides for separate delivery or separate acceptance of the additional units.

(4) *Statement with return*. If a taxpayer severs an agreement or aggregates two or more agreements under this paragraph (e) during the taxable year, the taxpayer must attach a statement to its original federal income tax return for that year. This statement must contain the following information—

(i) The legend NOTIFICATION OF SEVERANCE OR AGGREGATION UNDER SEC. 1.460–1(e);

(ii) The taxpayer's name; and

(iii) The taxpayer's employer identification number or social security number.

(f) *Classifying contracts*—(1) *In general*. After applying the severing and aggregating rules of paragraph (e) of this section, a taxpayer must determine the classification of a contract (e.g., as a long-term manufacturing contract, long-term

construction contract, non-long-term contract) based on all the facts and circumstances known no later than the end of the contracting year. Classification is determined on a contract-by-contract basis. Consequently, a requirement to manufacture a single unique item under a long-term contract will subject all other items in that contract to section 460.

(2) *Hybrid contracts*—(i) *In general*. A long-term contract that requires a taxpayer to perform both manufacturing and construction activities (hybrid contract) generally must be classified as two contracts, a manufacturing contract and a construction contract. A taxpayer may elect, on a contract-by-contract basis, to classify a hybrid contract as a long-term construction contract if at least 95 percent of the estimated total allocable contract costs are reasonably allocable to construction activities. In addition, a taxpayer may elect, on a contract-by-contract basis, to classify a hybrid contract as a long-term manufacturing contract subject to the PCM.

(ii) *Elections*. A taxpayer makes an election under this paragraph (f)(2) by using its method of accounting for similar construction contracts or for manufacturing contracts, whichever is applicable, to account for a hybrid contract entered into during the taxable year of the election on its original federal income tax return for the election year. If an electing taxpayer's method is the PCM, the taxpayer also must use the PCM to apply the look-back method under §1.460–6 and to determine alternative minimum taxable income under §1.460–4(f).

(3) *Method of accounting*. Except as provided in paragraph (f)(2)(ii) of this section, a taxpayer's method of classifying contracts is a method of accounting under section 446 and, thus, may not be changed without the Commissioner's consent. If a taxpayer's method of classifying contracts is unreasonable, that classification method is an impermissible accounting method.

(4) *Use of estimates*—(i) *Estimating length of contract*. A taxpayer must use a reasonable estimate of the time required to complete a contract when necessary to classify the contract (e.g., to determine whether the five-year completion rule for qualified ship contracts under §1.460–2(d), or the two-year completion rule for exempt construction contracts under §1.460–3(b), is satisfied, but not to determine whether a contract is completed within the contracting year under paragraph (b)(1) of this section). To be considered reasonable, an estimate of the time required to complete the contract must include anticipated time for delay, rework, change orders, technology or design problems, or other problems that reasonably can be anticipated considering the nature of the contract and prior experience. A contract term that specifies an expected completion or delivery date may be considered evidence that the taxpayer reasonably expects to complete or deliver the subject matter of the contract on or about the date specified, especially if the contract provides *bona fide* penalties for failing to meet the specified date. If a taxpayer classifies a contract based on a reasonable estimate of completion time, the contract will not be reclassified based on the actual (or another reasonable estimate of) completion time. A taxpayer's estimate of completion time will not be considered unreasonable if a contract is not completed within the estimated time primarily because of unforeseeable factors not within the taxpayer's control, such as third-party litigation, extreme weather conditions, strikes, or delays in securing permits or licenses.

(ii) *Estimating allocable contract costs*. A taxpayer must use a reasonable estimate of total allocable contract costs when necessary to classify the contract (e.g., to determine whether a contract is a home construction contract under §1.460–(3)(b)(2)). If a taxpayer classifies a contract based on a reasonable estimate of total allocable contract costs, the contract will not be reclassified based on the actual (or another reasonable estimate of) total 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*. Except as provided in paragraph (g)(1)(ii) of this section, if a related party and its customer enter into a long-term contract subject to the PCM, and a taxpayer performs any activity that is incident to or necessary for the related party's long-term contract, the taxpayer must account for the gross receipts and costs attributable to this activity using the PCM, even if this activity is not otherwise subject to section 460(a). This type of activity may include, for example, the performance of engineering and design services, and the production of components and subassemblies that are reasonably expected to be used in the production of the subject matter of the related party's contract.

(ii) *Exception for components and subassemblies*. A taxpayer is not required to use the PCM under this paragraph (g) to account for a component or subassembly that benefits a related party's long-term contract if more than 50 percent of the average annual gross receipts attributable to the sale of this item for the 3-taxable-year-period ending with the contracting year comes from unrelated parties.

(2) *Total contract price*. If a taxpayer is required to use the PCM under paragraph (g)(1)(i) of this section, the total contract price (as defined in §1.460–4(b)(4)(i)) is the fair market value of the taxpayer's activity that is incident to or necessary for the performance of the related party's long-term contract. The related party also must use the fair market value of the taxpayer's activity as the cost it incurs for the activity. The fair market value of the taxpayer's activity may or may not be the same as the amount the related party pays the taxpayer for that activity.

(3) *Completion factor*. To compute a contract's completion factor (as described in §1.460–4(b)(5)), the related party must take into account the fair market value of the taxpayer's activity that is incident to or necessary for the performance of the related party's long-term contract when the related party incurs the liability to the taxpayer for the activity, rather than when the taxpayer incurs the costs to perform the activity.

(h) *Effective date*—(1) *In general*. Except as otherwise provided, this section and §§1.460–2 through 1.460–5 are applicable for contracts entered into on or after January 11, 2001.

(2) *Change in method of accounting*. Any change in a taxpayer's method of accounting necessary to comply with this section and §§1.460–2 through 1.460–5 is a change in method of accounting to which the provisions of section 446 and the regulations thereunder apply. For the first taxable year that includes January 11, 2001, a taxpayer is granted the consent of the Commissioner to change its method of

accounting to comply with the provisions of this section and §§1.460–2 through 1.460–5 for long-term contracts entered into on or after January 11, 2001. A taxpayer that wants to change its method of accounting under this paragraph (h)(2) must follow the automatic consent procedures in Rev. Proc. 99–49 (1999–52 I.R.B. 725) (see §601.601(d)(2) of this chapter), except that the scope limitations in section 4.02 of Rev. Proc. 99–49 do not apply. Because a change under this paragraph (h)(2) is made on a cut-off basis, a section 481(a) adjustment is not permitted or required. Moreover, the taxpayer does not receive audit protection under section 7 of Rev. Proc. 99–49 for a change in method of accounting under this paragraph (h)(2). A taxpayer that wants to change its exempt-contract method of accounting is not granted the consent of the Commissioner under this paragraph (h)(2) and must file a Form 3115, "Application for Change in Accounting Method," to obtain consent. See Rev. Proc. 97–27 (1997–1 C.B. 680) (see §601.601(d)(2) of this chapter).

(i) [Reserved]

(j) *Examples*. The following examples illustrate the rules of this section:

Example 1. Contract for manufacture of property. B notifies C, an aircraft manufacturer, that it wants to purchase an aircraft of a particular type. At the time C receives the order, C has on hand several partially completed aircraft of this type; however, C does not have any completed aircraft of this type on hand. C and B agree that B will purchase one of these aircraft after it has been completed. C retains title to and risk of loss with respect to the aircraft until the sale takes place. The agreement between C and B is a contract for the manufacture of property under paragraph (b)(2)(i) of this section, even if labeled as a contract for the sale of property, because the manufacture of the aircraft is necessary for C's obligations under the agreement to be fulfilled and the manufacturing was not complete when B and C entered into the agreement.

Example 2. De minimis construction activity. C, a master developer whose taxable year ends December 31, owns 5,000 acres of undeveloped land with a cost basis of $5,000,000 and a fair market value of $50,000,000. To obtain permission from the local county government to improve this land, a service road must be constructed on this land to benefit all 5,000 acres. In 2001, C enters into a contract to sell a 1,000-acre parcel of undeveloped land to B, a residential developer, for its fair market value, $10,000,000. In this contract, C agrees to construct a service road running through the land that C is selling to B and through the 4,000 adjacent acres of undeveloped land that C has sold or will sell to other residential developers for its fair market value, $40,000,000. C reasonably estimates that it will incur allocable contract costs of $50,000 (excluding the cost of the land) to construct this service road, which will be owned and maintained by the county. C must reasonably allocate the cost of the service road among the benefitted parcels. The portion of the estimated total allocable contract costs that C allocates to the 1,000-acre parcel being sold to B (based upon its fair market value) is $10,000 ($50,000 x ($10,000,000 ÷ $50,000,000)). Construction of the service road is finished in 2002. Because the estimated total allocable contract costs attributable to C's construction activities, $10,000, are less than 10 percent of the contract's total contract price, $10,000,000, C's contract with B is not a construction contract under paragraph (b)(2)(ii) of this section. Thus, C's contract with B is not a long-term contract under paragraph (b)(2)(i) of this section, notwithstanding that construction of the service road is not completed in 2001.

Example 3. Completion—customer use. In 2002, C, whose taxable year ends December 31, enters into a contract to construct a building for B. In November of 2003, the building is completed in every respect necessary for its intended use, and B occupies the building. In early December of 2003, B notifies C of some minor deficiencies that need to be corrected, and C agrees to correct them in January 2004. C reasonably estimates that the cost of correcting these deficiencies will be less than five percent of the total allocable contract costs. C's contract is complete under paragraph (c)(3)(i)(A) of this section in 2003 because in that year, B used the building and C had incurred at least 95 percent of the total allocable contract costs attributable to the building. C must use a permissible method of accounting for any deficiency-related costs incurred after 2003.

Example 4. Completion—customer use. In 2001, C, whose taxable year ends December 31, agrees to construct a shopping center, which includes an adjoining parking lot, for B. By October 2002, C has finished constructing the retail portion of the shopping center. By December 2002, C has graded the entire parking lot, but has paved only one-fourth of it because inclement weather conditions prevented C from laying asphalt on the remaining three-fourths. In December 2002, B opens the retail portion of the shopping center and the paved portion of the parking lot to the general public. C reasonably estimates that the cost of paving the remaining three-fourths of the parking lot when weather permits will exceed five percent of C's total allocable contract costs. Even though B is using the subject matter of the contract, C's contract is not completed in December 2002 under paragraph (c)(3)(i)(A) of this section because C has not incurred at least 95 percent of the total allocable contract costs attributable to the subject matter.

Example 5. Completion—customer use. In 2001, C, whose taxable year ends December 31, agrees to manufacture 100 machines for B. By December 31, 2002, C has delivered 99 of the machines to B. C reasonably estimates that the cost of finishing the related work on the contract will be less than five percent of the total allocable contract costs. C's contract is not complete under paragraph (c)(3)(i)(A) of this section in 2002 because in that year, B is not using the subject matter of the contract (all 100 machines) for its intended purpose.

Example 6. Non-long-term contract activity. On January 1, 2001, C, whose taxable year ends December 31, enters into a single long-term contract to design and manufacture a satellite and to develop computer software enabling B to operate the satellite. At the end of 2001, C has not finished manufacturing the satellite. Designing the satellite and developing the computer software are non-long-term contract activities that are incident to and necessary for the taxpayer's manufacturing of the subject matter of a long-term contract because the satellite could not be manufactured without the design and would not operate without the software. Thus, under paragraph (d)(1) of this section, C must allocate these non-long-term contract activities to the long-term contract and account for the gross receipts and costs attributable to designing the satellite and developing computer software using the PCM.

Example 7. Non-long-term contract activity. C agrees to manufacture equipment for B under a long-term contract. In a separate contract, C agrees to design the equipment being manufactured for B under the long-term contract. Under paragraph (d)(1) of this section, C must allocate the gross receipts and costs related to the design to the long-term contract because designing the equipment is a non-long-term contract activity that is incident to and necessary for the manufacture of the subject matter of the long-term contract.

Example 8. Severance. On January 1, 2001, C, a construction contractor, and B, a real estate investor, enter into an agreement requiring C to build two office buildings in different areas of a large city. The agreement provides that the two office buildings will be completed by C and accepted by B in 2002 and 2003, respectively, and that C will be paid $1,000,000 and $1,500,000 for the two office buildings, respectively. The agreement will provide C with a reasonable profit from the construction of each building. Unless C is required to use the PCM to account for the contract, C is required to sever this contract under paragraph (e)(2) of this section because the buildings are independently priced, the agreement provides for separate delivery and acceptance of the buildings, and, as each building will generate a reasonable profit, a reasonable businessperson would have entered into separate agreements for the terms agreed upon for each building.

Example 9. Severance. C, a large construction contractor whose taxable year ends December 31, accounts for its construction contracts using the PCM and has elected to use the 10-percent method described in §1.460–4(b)(6). In September 2001, C enters into an agreement to construct four buildings in four different cities. The buildings are independently priced and the contract provides a reasonable profit for each of the buildings. In addition, the agreement requires C to complete one building per year in 2002, 2003, 2004, and 2005. As of December 31, 2001, C has incurred 25 percent of the estimated total allocable contract costs attributable to one of the buildings, but only five percent of the estimated total allocable contract costs attributable to all four buildings included in the agreement. C does not request the Commissioner's consent to sever this contract. Using the 10-percent method, C does not take into account any portion of the total contract price or any incurred allocable contract costs attributable to this agreement in 2001. Upon examination of C's 2001 tax return, the Commissioner determines that C entered into one agreement for four buildings rather than four sepa-

rate agreements each for one building solely to take advantage of the deferral obtained under the 10-percent method. Consequently, to clearly reflect the taxpayer's income, the Commissioner may require C to sever the agreement into four separate contracts under paragraph (e)(2) of this section because the buildings are independently priced, the agreement provides for separate delivery and acceptance of the buildings, and a reasonable businessperson would have entered into separate agreements for these buildings.

Example 10. Aggregation. In 2001, C, a shipbuilder, enters into two agreements with the Department of the Navy as the result of a single negotiation. Each agreement obligates C to manufacture a submarine. Because the submarines are of the same class, their specifications are similar. Because C has never manufactured submarines of this class, however, C anticipates that it will incur substantially higher costs to manufacture the first submarine, to be delivered in 2007, than to manufacture the second submarine, to be delivered in 2010. If the agreements are treated as separate contracts, the first contract probably will produce a substantial loss, while the second contract probably will produce substantial profit. Based upon these facts, aggregation is required under paragraph (e)(2) of this section because the submarines are interdependently priced and a reasonable businessperson would not have entered the first agreement without also entering into the second.

Example 11. Aggregation. In 2001, C, a manufacturer of aircraft and related equipment, agrees to manufacture 10 military aircraft for foreign government B and to deliver the aircraft by the end of 2003. When entering into the agreement, C anticipates that it might receive production orders from B over the next 20 years for as many as 300 more of these aircraft. The negotiated contract price reflects C's and B's consideration of the expected total cost of manufacturing the 10 aircraft, the risks and opportunities associated with the agreement, and the additional factors the parties considered relevant. The negotiated price provides a profit on the sale of the 10 aircraft even if C does not receive any additional production orders from B. It is unlikely, however, that C actually would have wanted to manufacture the 10 aircraft but for the expectation that it would receive additional production orders from B. In 2003, B accepts delivery of the 10 aircraft. At that time, B orders an additional 20 aircraft of the same type for delivery in 2007. When negotiating the price for the additional 20 aircraft, C and B consider the fact that the expected unit cost for this production run of 20 aircraft will be lower than the unit cost of the 10 aircraft completed and accepted in 2003, but substantially higher than the expected unit cost of future production runs. Based upon these facts, aggregation is not permitted under paragraph (e)(2) of this section. Because the parties negotiated the prices of both agreements considering only the expected production costs and risks for each agreement standing alone, the terms and conditions agreed upon for the first agreement are independent of the terms and conditions agreed upon for the second agreement. The fact that the agreement to manufacture 10 aircraft provides a profit for C indicates that a reasonable businessperson would have entered into that agreement without entering into the agreement to manufacture the additional 20 aircraft.

Example 12. Classification and completion. In 2001, C, whose taxable year ends December 31, agrees to manufacture and install an industrial machine for B. C elects under paragraph (f) of this section to classify the agreement as a long-term manufacturing contract and to account for it using the PCM. The agreement requires C to deliver the machine in August 2003 and to install and test the machine in B's factory. In addition, the agreement requires B to accept the machine when the tests prove that the machine's performance will satisfy the environmental standards set by the Environmental Protection Agency (EPA), even if B has not obtained the required operating permit. Because of technical difficulties, C cannot deliver the machine until December 2003, when B conditionally accepts delivery. C installs the machine in December 2003 and then tests it through February 2004. B accepts the machine in February 2004, but does not obtain the operating permit from the EPA until January 2005. Under paragraph (c)(3)(i)(B) of this section, C's contract is finally completed and accepted in February 2004, even though B does not obtain the operating permit until January 2005, because C completed all its obligations under the contract and B accepted the machine in February 2004.

§1.460–2 Long-term manufacturing contracts.

(a) *In general.* Section 460 generally requires a taxpayer to determine the income from a long-term manufacturing contract using the percentage-of-completion method described in §1.460–4(b) (PCM). A contract not completed in the contracting year is a long-term manufacturing contract if it involves the manufacture of personal property that is—

(1) A unique item of a type that is not normally carried in the finished goods inventory of the taxpayer; or

(2) An item that normally requires more than 12 calendar months to complete (regardless of the duration of the contract or the time to complete a deliverable quantity of the item).

(b) *Unique*—(1) *In general. Unique* means designed for the needs of a specific customer. To determine whether an item is designed for the needs of a specific customer, a taxpayer must consider the extent to which research, development, design, engineering, retooling, and similar activities (customizing activities) are required to manufacture the item and whether the item could be sold to other customers with little or no modification. A contract may require the taxpayer to manufacture more than one unit of a unique item. If a contract requires a taxpayer to manufacture more than one unit of the same item, the taxpayer must determine whether that item is unique by considering the customizing activities that would be needed to produce only the first unit. For the purposes of this paragraph (b), a taxpayer must consider the activities performed on its behalf by a subcontractor.

(2) *Safe harbors.* Notwithstanding paragraph (b)(1) of this section, an item is not unique if it satisfies one or more of the safe harbors in this paragraph (b)(2). If an item does not satisfy one or more safe harbors, the determination of uniqueness will depend on the facts and circumstances. The safe harbors are:

(i) *Short production period.* An item is not unique if it normally requires 90 days or less to complete. In the case of a contract for multiple units of an item, the item is not unique only if it normally requires 90 days or less to complete each unit of the item in the contract.

(ii) *Customized item.* An item is not unique if the total allocable contract costs attributable to customizing activities that are incident to or necessary for the manufacture of the item do not exceed 10 percent of the estimated total allocable contract costs allocable to the item. In the case of a contract for multiple units of an item, this comparison must be performed on the first unit of the item and the total allocable contract costs attributable to customizing activities that are incident to or necessary for the manufacture of the item must be allocated to the first unit.

(iii) *Inventoried item.* A unique item ceases to be unique no later than when the taxpayer normally includes similar items in its finished goods inventory.

(c) *Normal time to complete*—(1) *In general.* The amount of time normally required to complete an item is the item's reasonably expected *production period*, as described in §1.263A–12, determined at the end of the contracting year. Thus, in general, the expected production period for an item begins when a taxpayer incurs at least five percent of the costs that would be allocable to the item under §1.460–5 and ends when the item is ready to be held for sale and all reasonably expected production activities are complete. In the case of components that are assembled or reassembled into an item or unit at the customer's facility by the taxpayer's employees or agents, the production period ends when the components are

assembled or reassembled into an operable item or unit. To the extent that several distinct activities related to the production of the item are expected to occur simultaneously, the period during which these distinct activities occur is not counted more than once. Furthermore, when determining the normal time to complete an item, a taxpayer is not required to consider activities performed or costs incurred that would not be allocable contract costs under section 460 (e.g., independent research and development expenses (as defined in §1.460–1(b)(9)) and marketing expenses). Moreover, the time required to design and manufacture the first unit of an item for which the taxpayer intends to produce multiple units generally does not indicate the normal time to complete the item.

(2) *Production by related parties*. To determine the time normally required to complete an item, a taxpayer must consider all relevant production activities performed and costs incurred by itself and by related parties, as defined in §1.460–1(b)(4). For example, if a taxpayer's item requires a component or subassembly manufactured by a related party, the taxpayer must consider the time the related party takes to complete the component or subassembly and, for purposes of determining the beginning of an item's production period, the costs incurred by the related party that are allocable to the component or subassembly. However, if both requirements of the exception for components and subassemblies under §1.460–1(g)(1)(ii) are satisfied, a taxpayer does not consider the activities performed or the costs incurred by a related party when determining the normal time to complete an item.

(d) *Qualified ship contracts*. A taxpayer may determine the income from a long-term manufacturing contract that is a qualified ship contract using either the PCM or the percentage-of-completion/capitalized-cost method (PCCM) of accounting described in §1.460–4(e). A *qualified ship contract* is any contract entered into after February 28, 1986, to manufacture in the United States not more than 5 seagoing vessels if the vessels will not be manufactured directly or indirectly for the United States Government and if the taxpayer reasonably expects to complete the contract within 5 years of the contract commencement date. Under §1.460–1(e)(3)(i), a contract to produce more than 5 vessels for which the PCM would be required cannot be severed in order to be classified as a qualified ship contract.

(e) *Examples*. The following examples illustrate the rules of this section:

Example 1. Unique item and classification. In December 2001, C enters into a contract with B to design and manufacture a new type of industrial equipment. C reasonably expects the normal production period for this type of equipment to be eight months. Because the new type of industrial equipment requires a substantial amount of research, design, and engineering to produce, C determines that the equipment is a unique item and its contract with B is a long-term contract. After delivering the equipment to B in September 2002, C contracts with B to produce five additional units of that industrial equipment with certain different specifications. These additional units, which also are expected to take eight months to produce, will be delivered to B in 2003. C determines that the research, design, engineering, retooling, and similar customizing costs necessary to produce the five additional units of equipment does not exceed 10 percent of the first unit's share of estimated total allocable contract costs. Consequently, the additional units of equipment satisfy the safe harbor in paragraph (b)(2)(ii) of this section and are not unique items. Although C's contract with B to produce the five additional units is not completed within the contracting year, the contract is not a long-term contract since the additional units of equipment are not unique items and do not normally require more than 12 months to produce. C must classify its second contract with B as a non-long term contract, notwithstanding that it classified the previous contract with B for a similar item as a long-term contract, because the determination of whether a contract is a long-term contract is made on a contract-by-contract basis. A change in classification is not a change in method of accounting because the change in classification results from a change in underlying facts.

Example 2. 12-month rule—related party. C manufactures cranes. C purchases one of the crane's components from R, a related party under §1.460–1(b)(4). Less than 50 percent of R's gross receipts attributable to the sale of this component comes from sales to unrelated parties; thus, the exception for components and subassemblies under §1.460–1(g)(1)(ii) is not satisfied. Consequently, C must consider the activities of R as R incurs costs and performs the activities rather than as C incurs a liability to R. The normal time period between the time that both C and R incur five percent of the costs allocable to the crane and the time that R completes the component is five months. C normally requires an additional eight months to complete production of the crane after receiving the integral component from R. C's crane is an item of a type that normally requires more than 12 months to complete under paragraph (c) of this section because the production period from the time that both C and R incur five percent of the costs allocable to the crane until the time that production of the crane is complete is normally 13 months.

Example 3. 12-month rule—duration of contract. The facts are the same as in *Example 2*, except that C enters into a sales contract with B on December 31, 2001 (the last day of C's taxable year), and delivers a completed crane to B on February 1, 2002. C's contract with B is a long-term contract under paragraph (a)(2) of this section because the contract is not completed in the contracting year, 2001, and the crane is an item that normally requires more than 12 calendar months to complete (regardless of the duration of the contract).

Example 4. 12-month rule—normal time to complete. The facts are the same as in *Example 2*, except that C (and R) actually complete B's crane in only 10 calendar months. The contract is a long-term contract because the normal time to complete a crane, not the actual time to complete a crane, is the relevant criterion for determining whether an item is subject to paragraph (a)(2) of this section.

Example 5. Normal time to complete. C enters into a multi-unit contract to produce four units of an item. C does not anticipate producing any additional units of the item. C expects to perform the research, design, and development that are directly allocable to the particular item and to produce the first unit in the first 24 months. C reasonably expects the production period for each of the three remaining units will be 3 months. This contract is not a contract that involves the manufacture of an item that normally requires more than 12 months to complete because the normal time to complete the item is 3 months. However, the contract does not satisfy the 90-day safe harbor for unique items because the normal time to complete the first unit of this item exceeds 90 days. Thus, the contract might involve the manufacture of a unique item depending on the facts and circumstances.

§1.460–3 Long-term construction contracts.

(a) *In general*. Section 460 generally requires a taxpayer to determine the income from a long-term construction contract using the percentage-of-completion method described in §1.460–4(b) (PCM). A contract not completed in the contracting year is a long-term construction contract if it involves the building, construction, reconstruction, or rehabilitation of real property; the installation of an integral component to real property; or the improvement of real property (collectively referred to as construction). *Real property* means land, buildings, and *inherently permanent structures*, as defined in §1.263A–8(c)(3), such as roadways, dams, and bridges. Real property does not include vessels, offshore drilling platforms, or unsevered natural products of land. An *integral component to real property* includes property not produced at the site of the real property but intended to be permanently affixed to the real property, such as elevators and central heating and

cooling systems. Thus, for example, a contract to install an elevator in a building is a construction contract because a building is real property, but a contract to install an elevator in a ship is not a construction contract because a ship is not real property.

(b) *Exempt construction contracts*—(1) *In general*. The general requirement to use the PCM and the cost allocation rules described in §1.460–5(b) or (c) does not apply to any long-term construction contract described in this paragraph (b) (exempt construction contract). *Exempt construction contract* means any—

(i) Home construction contract; and

(ii) Other construction contract that a taxpayer estimates (when entering into the contract) will be completed within 2 years of the contract commencement date, provided the taxpayer satisfies the $10,000,000 gross receipts test described in paragraph (b)(3) of this section.

(2) *Home construction contract*—(i) *In general*. A long-term construction contract is a *home construction contract* if a taxpayer (including a subcontractor working for a general contractor) reasonably expects to attribute 80 percent or more of the estimated total allocable contract costs (including the cost of land, materials, and services), determined as of the close of the contracting year, to the construction of—

(A) Dwelling units, as defined in section 168(e)(2)(A)(ii)(I), contained in buildings containing 4 or fewer dwelling units (including buildings with 4 or fewer dwelling units that also have commercial units); and

(B) Improvements to real property directly related to, and located at the site of, the dwelling units.

(ii) *Townhouses and rowhouses*. Each townhouse or rowhouse is a separate building.

(iii) *Common improvements*. A taxpayer includes in the cost of the dwelling units their allocable share of the cost that the taxpayer reasonably expects to incur for any common improvements (e.g., sewers, roads, clubhouses) that benefit the dwelling units and that the taxpayer is contractually obligated, or required by law, to construct within the tract or tracts of land that contain the dwelling units.

(iv) *Mixed use costs*. If a contract involves the construction of both commercial units and dwelling units within the same building, a taxpayer must allocate the costs among the commercial units and dwelling units using a reasonable method or combination of reasonable methods, such as specific identification, square footage, or fair market value.

(3) *$10,000,000 gross receipts test*—(i) *In general*. Except as otherwise provided in paragraphs (b)(3)(ii) and (iii) of this section, the $10,000,000 gross receipts test is satisfied if a taxpayer's (or predecessor's) average annual gross receipts for the 3 taxable years preceding the contracting year do not exceed $10,000,000, as determined using the principles of the gross receipts test for small resellers under §1.263A–3(b).

(ii) *Single employer*. To apply the gross receipts test, a taxpayer is not required to aggregate the gross receipts of persons treated as a single employer solely under section 414(m) and any regulations prescribed under section 414.

(iii) *Attribution of gross receipts*. A taxpayer must aggregate a proportionate share of the construction-related gross receipts of any person that has a five percent or greater interest in the taxpayer. In addition, a taxpayer must aggregate a proportionate share of the construction-related gross receipts of any person in which the taxpayer has a five percent or greater interest. For this purpose, a taxpayer must determine ownership interests as of the first day of the taxpayer's contracting year and must include indirect interests in any corporation, partnership, estate, trust, or sole proprietorship according to principles similar to the constructive ownership rules under sections 1563(e), (f)(2), and (f)(3)(A). However, a taxpayer is not required to aggregate under this paragraph (b)(3)(iii) any construction-related gross receipts required to be aggregated under paragraph (b)(3)(i) of this section.

(c) *Residential construction contracts*. A taxpayer may determine the income from a long-term construction contract that is a residential construction contract using either the PCM or the percentage-of-completion/capitalized-cost method (PCCM) of accounting described in §1.460–4(e). A *residential construction contract* is a home construction contract, as defined in paragraph (b)(2) of this section, except that the building or buildings being constructed contain more than 4 dwelling units.

Par. 7. Section 1.460–4 is amended by adding paragraphs (a) through (i) to read as follows:

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

(a) *Overview*. This section prescribes permissible methods of accounting for long-term contracts. Paragraph (b) of this section describes the percentage-of-completion method under section 460(b) (PCM) that a taxpayer generally must use to determine the income from a long-term contract. Paragraph (c) of this section lists permissible methods of accounting for exempt construction contracts described in §1.460–3(b)(1) and describes the exempt-contract percentage-of-completion method (EPCM). Paragraph (d) of this section describes the completed-contract method (CCM), which is one of the permissible methods of accounting for exempt construction contracts. Paragraph (e) of this section describes the percentage-of-completion/capitalized-cost method (PCCM), which is a permissible method of accounting for qualified ship contracts described in §1.460–2(d) and residential construction contracts described in §1.460–3(c). Paragraph (f) of this section provides rules for determining the alternative minimum taxable income (AMTI) from long-term contracts that are not exempted under section 56. Paragraph (g) of this section provides rules concerning consistency in methods of accounting for long-term contracts. Paragraph (h) of this section provides examples illustrating the principles of this section. Paragraph (j) of this section provides rules for taxpayers that file consolidated tax returns.

(b) *Percentage-of-completion method*—(1) *In general*. Under the PCM, a taxpayer generally must include in income the portion of the *total contract price*, as defined in paragraph (b)(4)(i) of this section, that corresponds to the percentage of the entire contract that the taxpayer has completed during the taxable year. The percentage of completion must be determined by comparing allocable contract costs incurred with estimated total allocable contract costs. Thus, the taxpayer includes a portion of the total contract price in gross income as the taxpayer incurs allocable contract costs.

(2) *Computations*. To determine the income from a long-term contract, a taxpayer—

(i) Computes the *completion factor* for the contract, which is the ratio of the cumulative allocable contract costs that the taxpayer has incurred through the end of the taxable year to the estimated total allocable contract costs that the taxpayer reasonably expects to incur under the contract;

(ii) Computes the amount of *cumulative gross receipts* from the contract by multiplying the completion factor by the total contract price;

(iii) Computes the amount of *current-year gross receipts*, which is the difference between the amount of cumulative gross receipts for the current taxable year and the amount of cumulative gross receipts for the immediately preceding taxable year (the difference can be a positive or negative number); and

(iv) Takes both the current-year gross receipts and the allocable contract costs incurred during the current year into account in computing taxable income.

(3) *Post-completion-year income*. If a taxpayer has not included the total contract price in gross income by the completion year, as defined in §1.460–1(b)(6), the taxpayer must include the remaining portion of the total contract price in gross income for the taxable year following the completion year. For the treatment of post-completion costs, see paragraph (b)(5)(v) of this section. See §1.460–6(c)(1)(ii) for application of the look-back method as a result of adjustments to total contract price.

(4) *Total contract price*—(i) *In general*—(A) *Definition*. *Total contract price* means the amount that a taxpayer reasonably expects to receive under a long-term contract, including holdbacks, retainages, and cost reimbursements. See §1.460–6(c)(1)(ii) and (2)(vi) for application of the look-back method as a result of changes in total contract price.

(B) *Contingent compensation*. Any amount related to a contingent right under a contract, such as a bonus, award, incentive payment, and amount in dispute, is included in total contract price as soon as the taxpayer can reasonably predict that the amount will be earned, even if the all events test has not yet been met. For example, if a bonus is payable to a taxpayer for meeting an early completion date, the bonus is includible in total contract price at the time and to the extent that the taxpayer can reasonably predict the achievement of the corresponding objective. Similarly, a portion of the contract price that is in dispute is includible in total contract price at the time and to the extent that the taxpayer can reasonably predict that the dispute will be resolved in the taxpayer's favor (regardless of when the taxpayer actually receives payment or when the dispute is finally resolved). Total contract price does not include compensation that might be earned under any other agreement that the taxpayer expects to obtain from the same customer (e.g., exercised option or follow-on contract) if that other agreement is not aggregated under §1.460–1(e). For the purposes of this paragraph (b)(4)(i)(B), a taxpayer can reasonably predict that an amount of contingent income will be earned not later than when the taxpayer includes that amount in income for financial reporting purposes under generally accepted accounting principles. If a taxpayer has not included an amount of contingent compensation in total contract price under this paragraph (b)(4)(i) by the taxable year following the completion year, the taxpayer must account for that amount of contingent compensation using a permissible method of accounting. If it is determined after the taxable year following the completion year that an amount included in total contract price will not be earned, the taxpayer should deduct that amount in the year of the determination.

(C) *Non-long-term contract activities*. Total contract price includes an allocable share of the gross receipts attributable to a non-long-term contract activity, as defined in §1.460–1(d)(2), if the activity is incident to or necessary for the manufacture, building, installation, or construction of the subject matter of the long-term contract. Total contract price also includes amounts reimbursed for independent research and development expenses (as defined in §1.460–1(b)(9)), or for bidding and proposal costs, under a federal or cost-plus long-term contract (as defined in section 460(d)), regardless of whether the research and development, or bidding and proposal, activities are incident to or necessary for the performance of that long-term contract.

(ii) *Estimating total contract price*. A taxpayer must estimate the total contract price based upon all the facts and circumstances known as of the last day of the taxable year. For this purpose, an event that occurs after the end of the taxable year must be taken into account if its occurrence was reasonably predictable and its income was subject to reasonable estimation as of the last day of that taxable year.

(5) *Completion factor*—(i) *Allocable contract costs*. A taxpayer must use a cost allocation method permitted under either §1.460–5(b) or (c) to determine the amount of cumulative allocable contract costs and estimated total allocable contract costs that are used to determine a contract's completion factor. Allocable contract costs include a reimbursable cost that is allocable to the contract.

(ii) *Cumulative allocable contract costs*. To determine a contract's completion factor for a taxable year, a taxpayer must take into account the cumulative allocable contract costs that have been incurred, as defined in §1.460–1(b)(8), through the end of the taxable year.

(iii) *Estimating total allocable contract costs*. A taxpayer must estimate total allocable contract costs for each long-term contract based upon all the facts and circumstances known as of the last day of the taxable year. For this purpose, an event that occurs after the end of the taxable year must be taken into account if its occurrence was reasonably predictable and its cost was subject to reasonable estimation as of the last day of that taxable year. To be considered reasonable, an estimate of total allocable contract costs must include costs attributable to delay, rework, change orders, technology or design problems, or other problems that reasonably can be predicted considering the nature of the contract and prior experience. However, estimated total allocable contract costs do not include any contingency allowance for costs that, as of the end of the taxable year, are not reasonably predicted to be incurred in the performance of the contract. For example, estimated total allocable contract costs do not include any costs attributable to factors not reasonably predictable at the end of the taxable year, such as third-party litigation, extreme weather conditions, strikes, and delays in securing required permits

and licenses. In addition, the estimated costs of performing other agreements that are not aggregated with the contract under §1.460–1(e) that the taxpayer expects to incur with the same customer (e.g., follow-on contracts) are not included in estimated total allocable contract costs for the initial contract.

(iv) *Pre-contracting-year costs*. If a taxpayer reasonably expects to enter into a long-term contract in a future taxable year, the taxpayer must capitalize all costs incurred prior to entering into the contract that will be allocable to that contract (e.g., bidding and proposal costs). A taxpayer is not required to compute a completion factor, or to include in gross income any amount, related to allocable contract costs for any taxable year ending before the contracting year or, if applicable, the 10-percent year defined in paragraph (b)(6)(i) of this section. In that year, the taxpayer is required to compute a completion factor that includes all allocable contract costs that have been incurred as of the end of that taxable year (whether previously capitalized or deducted) and to take into account in computing taxable income the related gross receipts and the previously capitalized allocable contract costs. If, however, a taxpayer determines in a subsequent year that it will not enter into the long-term contract, the taxpayer must account for these pre-contracting-year costs in that year (e.g., as a deduction or an inventoriable cost) using the appropriate rules contained in other sections of the Code or regulations.

(v) *Post-completion-year costs*. If a taxpayer incurs an allocable contract cost after the completion year, the taxpayer must account for that cost using a permissible method of accounting. See §1.460–6(c)(1)(ii) for application of the look-back method as a result of adjustments to allocable contract costs.

(6) *10-percent method*—(i) *In general*. Instead of determining the income from a long-term contract beginning with the contracting year, a taxpayer may elect to use the 10-percent method under section 460(b)(5). Under the 10-percent method, a taxpayer does not include in gross income any amount related to allocable contract costs until the taxable year in which the taxpayer has incurred at least 10 percent of the estimated total allocable contract costs (10-percent year). A taxpayer must treat costs incurred before the 10-percent year as pre-contracting-year costs described in paragraph (b)(5)(iv) of this section.

(ii) *Election*. A taxpayer makes an election under this paragraph (b)(6) by using the 10-percent method for all long-term contracts entered into during the taxable year of the election on its original federal income tax return for the election year. This election is a method of accounting and, thus, applies to all long-term contracts entered into during and after the taxable year of the election. An electing taxpayer must use the 10-percent method to apply the look-back method under §1.460–6 and to determine alternative minimum taxable income under paragraph (f) of this section. This election is not available if a taxpayer uses the simplified cost-to-cost method described in §1.460–5(c) to compute the completion factor of a long-term contract.

(7) *Terminated contract*—(i) *Reversal of income*. If a long-term contract is terminated before completion and, as a result, the taxpayer retains ownership of the property that is the subject matter of that contract, the taxpayer must reverse the transaction in the taxable year of termination. To reverse the transaction, the taxpayer reports a loss (or gain) equal to the cumulative allocable contract costs reported under the contract in all prior taxable years less the cumulative gross receipts reported under the contract in all prior taxable years.

(ii) *Adjusted basis*. As a result of reversing the transaction under paragraph (b)(7)(i) of this section, a taxpayer will have an adjusted basis in the retained property equal to the cumulative allocable contract costs reported under the contract in all prior taxable years. However, if the taxpayer received and retains any consideration or compensation from the customer, the taxpayer must reduce the adjusted basis in the retained property (but not below zero) by the fair market value of that consideration or compensation. To the extent that the amount of the consideration or compensation described in the preceding sentence exceeds the adjusted basis in the retained property, the taxpayer must include the excess in gross income for the taxable year of termination.

(iii) *Look-back method*. The look-back method does not apply to a terminated contract that is subject to this paragraph (b)(7).

(c) *Exempt contract methods—(1) In general*. An *exempt contract method* means the method of accounting that a taxpayer must use to account for all its long-term contracts (and any portion of a long-term contract) that are exempt from the requirements of section 460(a). Thus, an exempt contract method applies to exempt construction contracts, as defined in §1.460–3(b); the non-PCM portion of a qualified ship contract, as defined in §1.460–2(d); and the non-PCM portion of a residential construction contract, as defined in §1.460–3(c). Permissible exempt contract methods include the PCM, the EPCM described in paragraph (c)(2) of this section, the CCM described in paragraph (d) of this section, or any other permissible method. See section 446.

(2) *Exempt-contract percentage-of-completion method*—(i) *In general*. Similar to the PCM described in paragraph (b) of this section, a taxpayer using the EPCM generally must include in income the portion of the total contract price, as described in paragraph (b)(4) of this section, that corresponds to the percentage of the entire contract that the taxpayer has completed during the taxable year. However, under the EPCM, the percentage of completion may be determined as of the end of the taxable year by using any method of cost comparison (such as comparing direct labor costs incurred to date to estimated total direct labor costs) or by comparing the work performed on the contract with the estimated total work to be performed, rather than by using the cost-to-cost comparison required by paragraphs (b)(2)(i) and (5) of this section, provided such method is used consistently and clearly reflects income. In addition, paragraph (b)(3) of this section (regarding post-completion-year income), paragraph (b)(6) of this section (regarding the 10-percent method) and §1.460–6 (regarding the look-back method) do not apply to the EPCM.

(ii) *Determination of work performed*. For purposes of the EPCM, the criteria used to compare the work performed on a contract as of the end of the taxable year with the estimated total work to be performed must clearly reflect the earning of income with respect to the contract. For

example, in the case of a roadbuilder, a standard of completion solely based on miles of roadway completed in a case where the terrain is substantially different may not clearly reflect the earning of income with respect to the contract.

(d) *Completed-contract method*—(1) *In general*. Except as otherwise provided in paragraph (d)(4) of this section, a taxpayer using the CCM to account for a long-term contract must take into account in the contract's completion year, as defined in §1.460–1(b)(6), the gross contract price and all allocable contract costs incurred by the completion year. A taxpayer may not treat the cost of any materials and supplies that are allocated to a contract, but actually remain on hand when the contract is completed, as an allocable contract cost.

(2) *Post-completion-year income and costs*. If a taxpayer has not included an item of contingent compensation (i.e., amounts for which the all events test has not been satisfied) in gross contract price under paragraph (d)(3) of this section by the completion year, the taxpayer must account for this item of contingent compensation using a permissible method of accounting. If a taxpayer incurs an allocable contract cost after the completion year, the taxpayer must account for that cost using a permissible method of accounting.

(3) *Gross contract price*. Gross contract price includes all amounts (including holdbacks, retainages, and reimbursements) that a taxpayer is entitled by law or contract to receive, whether or not the amounts are due or have been paid. In addition, gross contract price includes all bonuses, awards, and incentive payments, such as a bonus for meeting an early completion date, to the extent the all events test is satisfied. If a taxpayer performs a non-long-term contract activity, as defined in §1.460–1(d)(2), that is incident to or necessary for the manufacture, building, installation, or construction of the subject matter of one or more of the taxpayer's long-term contracts, the taxpayer must include an allocable share of the gross receipts attributable to that activity in the gross contract price of the contract(s) benefitted by that activity. Gross contract price also includes amounts reimbursed for independent research and development expenses (as defined in §1.460–1(b)(9)), or bidding and proposal costs, under a federal or cost-plus long-term contract (as defined in section 460(d)), regardless of whether the research and development, or bidding and proposal, activities are incident to or necessary for the performance of that long-term contract.

(4) *Contracts with disputed claims*—(i) *In general.* The special rules in this paragraph (d)(4) apply to a long-term contract accounted for using the CCM with a dispute caused by a customer's requesting a reduction of the gross contract price or the performance of additional work under the contract or by a taxpayer's requesting an increase in gross contract price, or both, on or after the date a taxpayer has tendered the subject matter of the contract to the customer.

(ii) *Taxpayer assured of profit or loss*. If the disputed amount relates to a customer's claim for either a reduction in price or additional work and the taxpayer is assured of either a profit or a loss on a long-term contract regardless of the outcome of the dispute, the gross contract price, reduced (but not below zero) by the amount reasonably in dispute, must be taken into account in the completion year. If the disputed amount relates to a taxpayer's claim for an increase in price and the taxpayer is assured of either a profit or a loss on a long-term contract regardless of the outcome of the dispute, the gross contract price must be taken into account in the completion year. If the taxpayer is assured a profit on the contract, all allocable contract costs incurred by the end of the completion year are taken into account in that year. If the taxpayer is assured a loss on the contract, all allocable contract costs incurred by the end of the completion year, reduced by the amount reasonably in dispute, are taken into account in the completion year.

(iii) *Taxpayer unable to determine profit or loss*. If the amount reasonably in dispute affects so much of the gross contract price or allocable contract costs that a taxpayer cannot determine whether a profit or loss ultimately will be realized from a long-term contract, the taxpayer may not take any of the gross contract price or allocable contract costs into account in the completion year.

(iv) *Dispute resolved*. Any part of the gross contract price and any allocable contract costs that have not been taken into account because of the principles described in paragraph (d)(4)(i), (ii), or (iii) of this section must be taken into account in the taxable year in which the dispute is resolved. If a taxpayer performs additional work under the contract because of the dispute, the term *taxable year in which the dispute is resolved* means the taxable year the additional work is completed, rather than the taxable year in which the outcome of the dispute is determined by agreement, decision, or otherwise.

(e) *Percentage-of-completion/capitalized-cost method*. Under the PCCM, a taxpayer must determine the income from a long-term contract using the PCM for the applicable percentage of the contract and its exempt contract method, as defined in paragraph (c) of this section, for the remaining percentage of the contract. For residential construction contracts described in §1.460–3(c), the applicable percentage is 70 percent, and the remaining percentage is 30 percent. For qualified ship contracts described in §1.460–2(d), the applicable percentage is 40 percent, and the remaining percentage is 60 percent.

(f) *Alternative minimum taxable income*—(1) *In general*. Under section 56(a)(3), a taxpayer (not exempt from the AMT under section 55(e)) must use the PCM to determine its AMTI from any long-term contract entered into on or after March 1, 1986, that is not a home construction contract, as defined in §1.460–3(b)(2). For AMTI purposes, the PCM must include any election under paragraph (b)(6) of this section (concerning the 10-percent method) or under §1.460–5(c) (concerning the simplified cost-to-cost method) that the taxpayer has made for regular tax purposes. For exempt construction contracts described in §1.460–3(b)(1)(ii), a taxpayer must use the simplified cost-to-cost method to determine the completion factor for AMTI purposes. Except as provided in paragraph (f)(2) of this section, a taxpayer must use AMTI costs and AMTI methods, such as the depreciation method described in section 56(a)(1), to determine the completion factor of a long-term contract

(except a home construction contract) for AMTI purposes.

(2) *Election to use regular completion factors*. Under this paragraph (f)(2), a taxpayer may elect for AMTI purposes to determine the completion factors of all of its long-term contracts using the methods of accounting and allocable contract costs used for regular federal income tax purposes. A taxpayer makes this election by using regular methods and regular costs to compute the completion factors of all long-term contracts entered into during the taxable year of the election for AMTI purposes on its original federal income tax return for the election year. This election is a method of accounting and, thus, applies to all long-term contracts entered into during and after the taxable year of the election. Although a taxpayer may elect to compute the completion factor of its long-term contracts using regular methods and regular costs, an election under this paragraph (f)(2) does not eliminate a taxpayer's obligation to comply with the requirements of section 55 when computing AMTI. For example, although a taxpayer may elect to use the depreciation methods used for regular tax purposes to compute the completion factor of its long-term contracts for AMTI purposes, the taxpayer must use the depreciation methods permitted by section 56 to compute AMTI.

(g) *Method of accounting*. A taxpayer that uses the PCM, EPCM, CCM, PCCM, or elects the 10-percent method or special AMTI method (or changes to another method of accounting with the Commissioner's consent) must apply the method(s) consistently for all similarly classified long-term contracts, until the taxpayer obtains the Commissioner's consent under section 446(e) to change to another method of accounting. A taxpayer-initiated change in method of accounting will be permitted only on a cut-off basis (i.e., for contracts entered into on or after the year of change), and thus, a section 481(a) adjustment will not be permitted or required.

(h) *Examples*. The following examples illustrate the rules of this section:

Example 1. PCM—estimating total contract price. C, whose taxable year ends December 31, determines the income from long-term contracts using the PCM. On January 1, 2001, C enters into a contract to design and manufacture a satellite (a unique item). The contract provides that C will be paid $10,000,000 for delivering the completed satellite by December 1, 2002. The contract also provides that C will receive a $3,000,000 bonus for delivering the satellite by July 1, 2002, and an additional $4,000,000 bonus if the satellite successfully performs its mission for five years. C is unable to reasonably predict if the satellite will successfully perform its mission for five years. If on December 31, 2001, C should reasonably expect to deliver the satellite by July 1, 2002, the estimated total contract price is $13,000,000 ($10,000,000 unit price + $3,000,000 production-related bonus). Otherwise, the estimated total contract price is $10,000,000. In either event, the $4,000,000 bonus is not includible in the estimated total contract price as of December 31, 2001, because C is unable to reasonably predict that the satellite will successfully perform its mission for five years.

Example 2. PCM—computing income. (i) C, whose taxable year ends December 31, determines the income from long-term contracts using the PCM. During 2001, C agrees to manufacture for the customer, B, a unique item for a total contract price of $1,000,000. Under C's contract, B is entitled to retain 10 percent of the total contract price until it accepts the item. By the end of 2001, C has incurred $200,000 of allocable contract costs and estimates that the total allocable contract costs will be $800,000. By the end of 2002, C has incurred $600,000 of allocable contract costs and estimates that the total allocable contract costs will be $900,000. In 2003, after completing the contract, C determines that the actual cost to manufacture the item was $750,000.

(ii) For each of the taxable years, C's income from the contract is computed as follows:

	Taxable Year 2001	Taxable Year 2002	Taxable Year 2003
(A) Cumulative incurred costs	$ 200,000	$ 600,000	$ 750,000
(B) Estimated total costs	800,000	900,000	750,000
(C) Completion factor: (A) ÷ (B)	25.00%	66.67%	100.00%
(D) Total contract price	1,000,000	1,000,000	1,000,000
(E) Cumulative gross receipts: (C) x (D)	250,000	666,667	1,000,000
(F) Cumulative gross receipts (prior year):	(0)	(250,000)	(666,667)
(G) Current-year gross receipts	250,000	416,667	333,333
(H) Cumulative incurred costs	200,000	600,000	750,000
(I) Cumulative incurred costs (prior year):	(0)	(200,000)	(600,000)
(J) Current-year costs	200,000	400,000	150,000
(K) Gross income: (G) - (J)	$ 50,000	$ 16,667	$ 183,333

Example 3. PCM—computing income with cost sharing. (i) C, whose taxable year ends December 31, determines the income from long-term contracts using the PCM. During 2001, C enters into a contract to manufacture a unique item. The contract specifies a target price of $1,000,000, a target cost of $600,000, and a target profit of $400,000. C and B will share the savings of any cost underrun (actual total incurred cost is less than target cost) and the additional cost of any cost overrun (actual total incurred cost is greater than target cost) as follows: 30 percent to C and 70 percent to B. By the end of 2001, C has incurred $200,000 of allocable contract costs and estimates that the total allocable contract costs will be $600,000. By the end of 2002, C has incurred $300,000 of allocable contract costs and estimates that the total allocable contract costs will be $400,000. In 2003, after completing the contract, C determines that the actual cost to manufacture the item was $700,000.

(ii) For each of the taxable years, C's income from the contract is computed as follows (note that the sharing of any cost underrun or cost overrun is reflected as an adjustment to C's target price under paragraph (b)(4)(i) of this section):

	Taxable Year		
	2001	2002	2003
(A) Cumulative incurred costs	$ 200,000	$ 300,000	$ 700,000
(B) Estimated total costs	600,000	400,000	700,000
(C) Completion factor: (A) ÷ (B)	33.33%	75.00%	100.00%
(D) Target price	$ 1,000,000	$ 1,000,000	$ 1,000,000
(E) Estimated total costs	600,000	400,000	700,000
(F) Target costs	600,000	600,000	600,000
(G) Cost (underrun)/overrun: (E)-(F)	0	(200,000)	100,000
(H) Adjustment rate	70%	70%	70%
(I) Target price adjustment	0	(140,000)	70,000
(J) Total contract price: (D) + (I)	$ 1,000,000	$ 860,000	$ 1,070,000
(K) Cumulative gross receipts: (C) × (J)	$ 333,333	$ 645,000	$ 1,070,000
(L) Cumulative gross receipts (prior year):	(0)	(333,333)	(645,000)
(M) Current-year gross receipts	333,333	311,667	425,000
(N) Cumulative incurred costs	200,000	300,000	700,000
(O) Cumulative incurred costs (prior year):	(0)	(200,000)	(300,000)
(P) Current-year costs	200,000	100,000	400,000
(Q) Gross income: (M)-(P)	$ 133,333	$ 211,667	$ 25,000

Example 4. PCM—10 percent method. (i) C, whose taxable year ends December 31, determines the income from long-term contracts using the PCM. In November 2001, C agrees to manufacture a unique item for $1,000,000. C reasonably estimates that the total allocable contract costs will be $600,000. By December 31, 2001, C has received $50,000 in progress payments and incurred $40,000 of costs. C elects to use the 10 percent method effective for 2001 and all subsequent taxable years. During 2002, C receives $500,000 in progress payments and incurs $260,000 of costs. In 2003, C incurs an additional $300,000 of costs, C finishes manufacturing the item, and receives the final $450,000 payment.

(ii) For each of the taxable years, C's income from the contract is computed as follows:

	Taxable Year		
	2001	2002	2003
(A) Cumulative incurred costs	$ 40,000	$ 300,000	$ 600,000
(B) Estimated total costs	600,000	600,000	600,000
(C) Completion factor: (A) ÷ (B)	6.67%	50.00%	100.00%
(D) Total contract price	1,000,000	1,000,000	1,000,000
(E) Cumulative gross receipts: (C) × (D)*	0	500,000	1,000,000
(F) Cumulative gross receipts (prior year):	(0)	(0)	(500,000)
(G) Cumulative-year gross receipts	0	500,000	500,000
(H) Cumulative incurred costs	0	300,000	600,000
(I) Cumulative incurred costs (prior year):	(0)	(0)	(300,000)
(J) Current-year costs	0	300,000	300,000
(K) Gross income: (G) - (J)	$ 0	$ 200,000	$ 200,000

* Unless (C) < 10 percent.

Example 5. PCM–contract terminated. C, whose taxable year ends December 31, determines the income from long-term contracts using the PCM. During 2001, C buys land and begins constructing a building that will contain 50 condominium units on that land. C enters into a contract to sell one unit in this condominium to B for $240,000. B gives C a $5,000 deposit toward the purchase price. By the end of 2001, C has incurred $50,000 of allocable contract costs on B's unit and estimates that the total allocable contract costs on B's unit will be $150,000. Thus, for 2001, C reports gross receipts of $80,000 ($50,000 ÷ $150,000 x $240,000), current-year costs of $50,000, and gross income of $30,000 ($80,000 - $50,000). In 2002, after C has incurred an additional $25,000 of allocable contract costs on B's unit, B files for bankruptcy protection and defaults on the contract with C, who is permitted to keep B's $5,000 deposit as liquidated damages. In 2002, C reverses the transaction with B under paragraph (b)(7) of this section and reports a loss of $30,000 ($50,000 - $80,000). In addition, C obtains an adjusted basis in the unit sold to B of $70,000 ($50,000 (current-year costs deducted in 2001) - $5,000 (B's forfeited deposit) + $25,000 (current-year costs incurred in 2002). C may not apply the look-back method to this contract in 2002.

Example 6. CCM–contracts with disputes from customer claims. In 2001, C, whose taxable year ends December 31, uses the CCM to account for exempt construction contracts. C enters into a contract to construct a bridge for B. The terms of the contract provide for a $1,000,000 gross contract price. C finishes the bridge in 2002 at a cost of $950,000. When B examines the bridge, B insists that C either repaint several girders or reduce the contract price. The amount reasonably in dispute is $10,000. In 2003, C and B resolve their dispute, C repaints the girders at a cost of $6,000, and C and B agree that the contract price is not to be reduced. Because C is assured a profit of $40,000 ($1,000,000 - $10,000 - $950,000) in 2002 even if the dispute is resolved in B's favor, C must take this $40,000 into account in 2002. In 2003, C will earn an additional $4,000 profit ($1,000,000 - $956,000 -

$40,000) from the contract with B. Thus, C must take into account an additional $10,000 of gross contract price and $6,000 of additional contract costs in 2003.

Example 7. CCM–contracts with disputes from taxpayer claims. In 2003, C, whose taxable year ends December 31, uses the CCM to account for exempt construction contracts. C enters into a contract to construct a building for B. The terms of the contract provide for a $1,000,000 gross contract price. C finishes the building in 2004 at a cost of $1,005,000. B examines the building in 2004 and agrees that it meets the contract's specifications; however, at the end of 2004, C and B are unable to agree on the merits of C's claim for an additional $10,000 for items that C alleges are changes in contract specifications and B alleges are within the scope of the contract's original specifications. In 2005, B agrees to pay C an additional $2,000 to satisfy C's claims under the contract. Because the amount in dispute affects so much of the gross contract price that C cannot determine in 2004 whether a profit or loss will ultimately be realized, C may not take any of the gross contract price or allocable contract costs into account in 2004. C must take into account $1,002,000 of gross contract price and $1,005,000 of allocable contract costs in 2005.

Example 8. CCM–contracts with disputes from taxpayer and customer claims. C, whose taxable year ends December 31, uses the CCM to account for exempt construction contracts. C constructs a factory for B pursuant to a long-term contract. Under the terms of the contract, B agrees to pay C a total of $1,000,000 for construction of the factory. C finishes construction of the factory in 2002 at a cost of $1,020,000. When B takes possession of the factory and begins operations in December 2002, B is dissatisfied with the location and workmanship of certain heating ducts. As of the end of 2002, C contends that the heating ducts are constructed in accordance with contract specifications. The amount of the gross contract price reasonably in dispute with respect to the heating ducts is $6,000. As of this time, C is claiming $14,000 in addition to the original contract price for certain changes in contract specifications which C alleges have increased his costs. B denies that these changes have increased C's costs. In 2003, the disputes between C and B are resolved by performance of additional work by C at a cost of $1,000 and by an agreement that the contract price would be revised downward to $996,000. Under these circumstances, C must include in his gross income for 2002, $994,000 (the gross contract price less the amount reasonably in dispute because of B's claim, or $1,000,000 - $6,000). In 2002, C must also take into account $1,000,000 of allocable contract costs (costs incurred less the amounts in dispute attributable to both B's and C's claims, or $1,020,000 -$6,000 - $14,000). In 2003, C must take into account an additional $2,000 of gross contract price ($996,000 - $994,000) and $21,000 of allocable contract costs ($1,021,000 - $1,000,000).

(i) [Reserved]

* * * * *

(k) *Mid-contract change in taxpayer*. [Reserved]

Par. 8. Section 1.460–5 is added to read as follows:

§1.460–5 Cost allocation rules.

(a) *Overview*. This section prescribes methods of allocating costs to long-term contracts accounted for using the percentage-of-completion method described in §1.460–4(b) (PCM), the completed-contract method described in §1.460–4(d) (CCM), or the percentage-of-completion/capitalized-cost method described in §1.460–4(e) (PCCM). Exempt construction contracts described in §1.460–3(b) accounted for using a method other than the PCM or CCM are not subject to the cost allocation rules of this section (other than the requirement to allocate production-period interest under paragraph (b)(2)(v) of this section). Paragraph (b) of this section describes the regular cost allocation methods for contracts subject to the PCM. Paragraph (c) of this section describes an elective simplified cost allocation method for contracts subject to the PCM. Paragraph (d) of this section describes the cost allocation methods for exempt construction contracts reported using the CCM. Paragraph (e) of this section describes the cost allocation rules for contracts subject to the PCCM. Paragraph (f) of this section describes additional rules applicable to the cost allocation methods described in this section. Paragraph (g) of this section provides rules concerning consistency in method of allocating costs to long-term contracts.

(b) *Cost allocation method for contracts subject to PCM*—(1) *In general*. Except as otherwise provided in paragraph (b)(2) of this section, a taxpayer must allocate costs to each long-term contract subject to the PCM in the same manner that direct and indirect costs are capitalized to property produced by a taxpayer under §1.263A–1(e) through (h). Thus, a taxpayer must allocate to each long-term contract subject to the PCM all direct costs and certain indirect costs properly allocable to the long-term contract (i.e., all costs that directly benefit or are incurred by reason of the performance of the long-term contract). However, see paragraph (c) of this section concerning an election to allocate contract costs using the simplified cost-to-cost method. As in section 263A, the use of the practical capacity concept is not permitted. See §1.263A–2(a)(4).

(2) *Special rules*—(i) *Direct material costs*. The costs of direct materials must be allocated to a long-term contract when dedicated to the contract under principles similar to those in §1.263A–11(b)(2). Thus, a taxpayer dedicates direct materials by associating them with a specific contract, including by purchase order, entry on books and records, or shipping instructions. A taxpayer maintaining inventories under §1.471–1 must determine allocable contract costs attributable to direct materials using its method of accounting for those inventories (e.g., FIFO, LIFO, specific identification).

(ii) *Components and subassemblies*. The costs of a component or subassembly (component) produced by the taxpayer must be allocated to a long-term contract as the taxpayer incurs costs to produce the component if the taxpayer reasonably expects to incorporate the component into the subject matter of the contract. Similarly, the cost of a purchased component (including a component purchased from a related party) must be allocated to a long-term contract as the taxpayer incurs the cost to purchase the component if the taxpayer reasonably expects to incorporate the component into the subject matter of the contract. In all other cases, the cost of a component must be allocated to a long-term contract when the component is dedicated, under principles similar to those in §1.263A–11(b)(2). A taxpayer maintaining inventories under §1.471–1 must determine allocable contract costs attributable to components using its method of accounting for those inventories (e.g., FIFO, LIFO, specific identification).

(iii) *Simplified production methods*. A taxpayer may not determine allocable contract costs using the simplified production methods described in §1.263A–2(b) and (c).

(iv) *Costs identified under cost-plus long-term contracts and federal long-term contracts*. To the extent not otherwise allocated to the contract under this paragraph (b), a taxpayer must allocate any identified costs to a cost-plus long-term contract or federal long-term contract (as

defined in section 460(d)). *Identified cost* means any cost, including a charge representing the time-value of money, identified by the taxpayer or related person as being attributable to the taxpayer's cost-plus long-term contract or federal long-term contract under the terms of the contract itself or under federal, state, or local law or regulation.

(v) *Interest*—(A) *In general*. If property produced under a long-term contract is *designated property*, as defined in §1.263A–8(b) (without regard to the exclusion for long-term contracts under §1.263A–8(d)(2)(v)), a taxpayer must allocate interest incurred during the production period to the long-term contract in the same manner as interest is allocated to property produced by a taxpayer under section 263A(f). See §§1.263A–8 to 1.263A–12 generally.

(B) *Production period*. Notwithstanding §1.263A–12(c) and (d), for purposes of this paragraph (b)(2)(v), the production period of a long-term contract—

(*1*) Begins on the later of—

(*i*) The contract commencement date, as defined in §1.460–1(b)(7); or

(*ii*) For a taxpayer using the accrual method of accounting for long-term contracts, the date by which 5 percent or more of the total estimated costs, including design and planning costs, under the contract have been incurred; and

(*2*) Ends on the date that the contract is completed, as defined in §1.460–1(c)(3).

(C) *Application of section 263A(f)*. For purposes of this paragraph (b)(2)(v), section 263A(f)(1)(B)(iii) (regarding an estimated production period exceeding 1 year and a cost exceeding $1,000,000) must be applied on a contract-by-contract basis; except that, in the case of a taxpayer using an accrual method of accounting, that section must be applied on a property-by-property basis.

(vi) *Research and experimental expenses*. Notwithstanding §1.263A–1(e)(3)(ii)(P) and (iii)(B), a taxpayer must allocate research and experimental expenses, other than independent research and development expenses (as defined in §1.460–1(b)(9)), to its long-term contracts.

(vii) *Service costs*—(A) *Simplified service cost method*—(1) *In general*. To use the simplified service cost method under §1.263A–1(h), a taxpayer must allocate the otherwise capitalizable mixed service costs among its long-term contracts using a reasonable method. For example, otherwise capitalizable mixed service costs may be allocated to each long-term contract based on labor hours or contract costs allocable to the contract. To be considered reasonable, an allocation method must be applied consistently and must not disproportionately allocate service costs to contracts expected to be completed in the near future.

(2) *Example*. The following example illustrates the rule of this paragraph (b)(2)(vii)(A):

Example. *Simplified service cost method*. During 2001, C, whose taxable year ends December 31, produces electronic equipment for inventory and enters into long-term contracts to manufacture specialized electronic equipment. C's method of allocating mixed service costs to the property it produces is the labor-based, simplified service cost method described in §1.263A–1(h)(4). For 2001, C's total mixed service costs are $100,000, C's section 263A labor costs are $500,000, C's section 460 labor costs (i.e., labor costs allocable to C's long-term contracts) are $250,000, and C's total labor costs are $1,000,000. To determine the amount of mixed service costs capitalizable under section 263A for 2001, C multiplies its total mixed service costs by its section 263A allocation ratio (section 263A labor costs ÷ total labor costs). Thus, C's capitalizable mixed service costs for 2001 are $50,000 ($100,000 x $500,000 ÷ $1,000,000). Thereafter, C allocates its capitalizable mixed service costs to produced property remaining in ending inventory using its 263A allocation method (e.g., burden rate, simplified production). Similarly, to determine the amount of mixed service costs that are allocable to C's long-term contracts for 2001, C multiplies its total mixed service costs by its section 460 allocation ratio (section 460 labor ÷ total labor costs). Thus, C's allocable mixed service contract costs for 2001 are $25,000 ($100,000 x $250,000 ÷ $1,000,000). Thereafter, C allocates its allocable mixed service costs to its long-term contracts proportionately based on its section 460 labor costs allocable to each long-term contract.

(B) *Jobsite costs*. If an administrative, service, or support function is performed solely at the jobsite for a specific long-term contract, the taxpayer may allocate all the direct and indirect costs of that administrative, service, or support function to that long-term contract. Similarly, if an administrative, service, or support function is performed at the jobsite solely for the taxpayer's long-term contract activities, the taxpayer may allocate all the direct and indirect costs of that administrative, service, or support function among all the long-term contracts performed at that jobsite. For this purpose, *jobsite* means a production plant or a construction site.

(C) *Limitation on other reasonable cost allocation methods*. A taxpayer may use any other reasonable method of allocating service costs, as provided in §1.263A–1(f)(4), if, for the taxpayer's long-term contracts considered as a whole, the—

(*1*) Total amount of service costs allocated to the contracts does not differ significantly from the total amount of service costs that would have been allocated to the contracts under §1.263A–1(f)(2) or (3);

(*2*) Service costs are not allocated disproportionately to contracts expected to be completed in the near future because of the taxpayer's cost allocation method; and

(*3*) Taxpayer's cost allocation method is applied consistently.

(c) *Simplified cost-to-cost method for contracts subject to the PCM*—(1) *In general*. Instead of using the cost allocation method prescribed in paragraph (b) of this section, a taxpayer may elect to use the simplified cost-to-cost method, which is authorized under section 460(b)(3)(A), to allocate costs to a long-term contract subject to the PCM. Under the simplified cost-to-cost method, a taxpayer determines a contract's completion factor based upon only direct material costs; direct labor costs; and depreciation, amortization, and cost recovery allowances on equipment and facilities directly used to manufacture or construct the subject matter of the contract. For this purpose, the costs associated with any manufacturing or construction activities performed by a subcontractor are considered either direct material or direct labor costs, as appropriate, and therefore must be allocated to the contract under the simplified cost-to-cost method. An electing taxpayer must use the simplified cost-to-cost method to apply the look-back method under §1.460-6 and to determine alternative minimum taxable income under §1.460–4(f).

(2) *Election*. A taxpayer makes an election under this paragraph (c) by using the simplified cost-to-cost method for all long-term contracts entered into during the taxable year of the election on its original federal income tax return for the election year. This election is a method of accounting and, thus, applies to all long-term contracts entered into during and after the taxable year of the election. This election is not available if a taxpayer does

not use the PCM to account for all long-term contracts or if a taxpayer elects to use the 10-percent method described in §1.460–4(b)(6).

(d) *Cost allocation rules for exempt construction contracts reported using the CCM*—(1) *In general*. For exempt construction contracts reported using the CCM, other than contracts described in paragraph (d)(3) of this section (concerning contracts of homebuilders that do not satisfy the $10,000,000 gross receipts test described in §1.460–3(b)(3) or will not be completed within two years of the contract commencement date), a taxpayer must annually allocate the cost of any activity that is incident to or necessary for the taxpayer's performance under a long-term contract. A taxpayer must allocate to each exempt construction contract all direct costs as defined in §1.263A–1(e)(2)(i) and all indirect costs either as provided in §1.263A–1(e)(3) or as provided in paragraph (d)(2) of this section.

(2) *Indirect costs*—(i) *Indirect costs allocable to exempt construction contracts*. A taxpayer allocating costs under this paragraph (d)(2) must allocate the following costs to an exempt construction contract, other than a contract described in paragraph (d)(3) of this section, to the extent incurred in the performance of that contract—

(A) Repair of equipment or facilities;

(B) Maintenance of equipment or facilities;

(C) Utilities, such as heat, light, and power, allocable to equipment or facilities;

(D) Rent of equipment or facilities;

(E) Indirect labor and contract supervisory wages, including basic compensation, overtime pay, vacation and holiday pay, sick leave pay (other than payments pursuant to a wage continuation plan under section 105(d) as it existed prior to its repeal in 1983), shift differential, payroll taxes, and contributions to a supplemental unemployment benefits plan;

(F) Indirect materials and supplies;

(G) Noncapitalized tools and equipment;

(H) Quality control and inspection;

(I) Taxes otherwise allowable as a deduction under section 164, other than state, local, and foreign income taxes, to the extent attributable to labor, materials, supplies, equipment, or facilities;

(J) Depreciation, amortization, and cost-recovery allowances reported for the taxable year for financial purposes on equipment and facilities to the extent allowable as deductions under chapter 1 of the Internal Revenue Code;

(K) Cost depletion;

(L) Administrative costs other than the cost of selling or any return on capital;

(M) Compensation paid to officers other than for incidental or occasional services;

(N) Insurance, such as liability insurance on machinery and equipment; and

(O) Interest, as required under paragraph (b)(2)(v) of this section.

(ii) *Indirect costs not allocable to exempt construction contracts*. A taxpayer allocating costs under this paragraph (d)(2) is not required to allocate the following costs to an exempt construction contract reported using the CCM—

(A) Marketing and selling expenses, including bidding expenses;

(B) Advertising expenses;

(C) Other distribution expenses;

(D) General and administrative expenses attributable to the performance of services that benefit the taxpayer's activities as a whole (e.g., payroll expenses, legal and accounting expenses);

(E) Research and experimental expenses (described in section 174 and the regulations thereunder);

(F) Losses under section 165 and the regulations thereunder;

(G) Percentage of depletion in excess of cost depletion;

(H) Depreciation, amortization, and cost recovery allowances on equipment and facilities that have been placed in service but are temporarily idle (for this purpose, an asset is not considered to be temporarily idle on non-working days, and an asset used in construction is considered to be idle when it is neither en route to nor located at a job-site), and depreciation, amortization and cost recovery allowances under chapter 1 of the Internal Revenue Code in excess of depreciation, amortization, and cost recovery allowances reported by the taxpayer in the taxpayer's financial reports;

(I) Income taxes attributable to income received from long-term contracts;

(J) Contributions paid to or under a stock bonus, pension, profit-sharing, or annuity plan or other plan deferring the receipt of compensation whether or not the plan qualifies under section 401(a), and other employee benefit expenses paid or accrued on behalf of labor, to the extent the contributions or expenses are otherwise allowable as deductions under chapter 1 of the Internal Revenue Code. Other employee benefit expenses include (but are not limited to): worker's compensation; amounts deductible or for whose payment reduction in earnings and profits is allowed under section 404A and the regulations thereunder; payments pursuant to a wage continuation plan under section 105(d) as it existed prior to its repeal in 1983; amounts includible in the gross income of employees under a method or arrangement of employer contributions or compensation which has the effect of a stock bonus, pension, profit-sharing, or annuity plan, or other plan deferring the receipt of compensation or providing deferred benefits; premiums on life and health insurance; and miscellaneous benefits provided for employees such as safety, medical treatment, recreational and eating facilities, membership dues, etc.;

(K) Cost attributable to strikes, rework labor, scrap and spoilage; and

(L) Compensation paid to officers attributable to the performance of services that benefit the taxpayer's activities as a whole.

(3) *Large homebuilders*. A taxpayer must capitalize the costs of home construction contracts under section 263A and the regulations thereunder, unless the contract will be completed within two years of the contract commencement date and the taxpayer satisfies the $10,000,000 gross receipts test described in §1.460–3(b)(3).

(e) *Cost allocation rules for contracts subject to the PCCM*. A taxpayer must use the cost allocation rules described in paragraph (b) of this section to determine the costs allocable to the entire qualified ship contract or residential construction contract accounted for using the PCCM and may not use the simplified cost-to-cost method described in paragraph (c) of this section.

(f) *Special rules applicable to costs allocated under this section*—(1) *Nondeductible costs*. A taxpayer may not allocate any otherwise allocable contract cost to a long-term contract if any section of the Internal Revenue Code disallows a deduction for that type of payment or

expenditure (e.g., an illegal bribe described in section 162(c)).

(2) *Costs incurred for non-long-term contract activities*. If a taxpayer performs a non-long-term contract activity, as defined in §1.460–1(d)(2), that is incident to or necessary for the manufacture, building, installation, or construction of the subject matter of one or more of the taxpayer's long-term contracts, the taxpayer must allocate the costs attributable to that activity to such contract(s).

(g) *Method of accounting*. A taxpayer that adopts or elects a cost allocation method of accounting (or changes to another cost allocation method of accounting with the Commissioner's consent) must apply that method consistently for all similarly classified contracts, until the taxpayer obtains the Commissioner's consent under section 446(e) to change to another cost allocation method. A taxpayer-initiated change in cost allocation method will be permitted only on a cut-off basis (i.e., for contracts entered into on or after the year of change, and thus, a section 481(a) adjustment will not be permitted or required.

Par. 9. Section 1.460–6 is amended as follows:

1. A sentence is added to the end of paragraph (a)(2).

2. The third sentence of paragraph (b)(1) is removed.

3. In the fourth sentence of paragraph (b)(1), "Therefore, to the extent that the percentage of completion method is required to be used" is removed and "To the extent that the percentage of completion method is required to be used under § 1.460–1(g)" is added in its place.

4. The first sentence of paragraph (c)(1)(ii)(A) is revised.

5. In the first sentence of paragraph (c)(1)(ii)(B), the language "no later than the year" is removed and "in the year" is added in its place and "§1.451–3(b)(2)" is removed and "§1.460–1(c)(3)" is added in its place.

6. The last two sentences of paragraph (c)(1)(ii)(B) are removed.

7. In the last sentence of paragraph (c)(1)(ii)(C)(*2*), the language "§5h.6" is removed and "§301.9100–8 of this chapter" is added in its place.

8. In the fourth sentence of paragraph (c)(2)(v)(A), the language "similarly" is removed.

9. The first, second, fifth, and sixth sentences of paragraph (c)(2)(v)(A) are removed.

10. In the first sentence of paragraph (c)(2)(vi)(B), the language "§1.451–3 (b)(2)(ii), (iii), (iv), and §1.451–3(d)(2), (3), and (4)" is removed and "§1.460–4 (b)(4)(i)" is added in its place.

11. In the second sentence of paragraph (c)(2)(vi)(B), the language "the percentage of completion method and" is removed.

12. In the third sentence of paragraph (c)(2)(vi)(B), the language ", for purposes of both the percentage of completion method and the look-back method" is removed.

13. In the fourth sentence of paragraph (c)(2)(vi)(B), the language "Similarly, a" is removed and "A" is added in its place.

14. In the first sentence of paragraph (c)(2)(vi)(C), the language "§1.451–3(e)" is removed and "§1.460–1(e)" is added in its place.

15. Paragraph (c)(4)(iv) is removed.

16. In the first sentence of paragraph (d)(4)(ii)(C), the language "within the meaning of section 1504(a)" is removed and ", as defined in § 1.1502–1(h)" is added in its place.

17. In the fourth sentence of paragraph (e)(2), the language "within the meaning of section 1504(a)" is removed and ", as defined in §1.1502–1(h)" is added in its place.

18. In the first sentence of paragraph (f)(1), the language "or to be refunded" is removed and "from, or payable to, a taxpayer" is added in its place.

19. In the first sentence of paragraph (f)(1), the language "and reported" is removed.

20. In the second sentence of paragraph (f)(1), the language "and Form 8697 is filed by" is removed.

21. In the second sentence of paragraph (f)(2)(i), the language "fails to file Form 8697 with respect to interest required to be paid or that" is removed.

22. In the second sentence of paragraph (f)(2)(i), the language "a penalty for failing to file Form 8697" is removed and "an underpayment penalty under section 6651, and the taxpayer also is liable for underpayment interest under section 6601" is added in its place.

23. In the third sentence of paragraph (f)(2)(i), the language "penalty" is removed and "subtitle F" is added in its place.

24. In the fourth sentence of paragraph (f)(2)(i), the language "or a tax refund" is added after "liability".

25. In the first sentence of paragraph (f)(2)(ii), the language "refunded" is removed and "payable" is added in its place.

26. Paragraph (f)(3) is added.

The revisions and additions read as follows:

§1.460–6 Look-back method.

(a) * * *

(2) * * * Paragraph (j) of this section provides guidance concerning the election not to apply the look-back method in *de minimis* cases.

* * * * *

(c) * * *(1) * * *

(ii) * * *(A) *In general*. Except as otherwise provided in section 460(b)(6) (see §1.460–6(j) for method of electing) or §1.460–6(e), a taxpayer must apply the look-back method to a long-term contract in the completion year and in any post-completion year for which the taxpayer must adjust total contract price or total allocable contract costs, or both, under the PCM. * * *

* * * * *

(f) * * *

(3). *Statue of limitations and compounding of interest on look-back interest.* For guidance on the statute of limitations applicable to the assessment and collection of look-back interest owed by a taxpayer, see sections 6501 and 6502. A taxpayer's claim for credit or refund of look-back interest previously paid by or collected from a taxpayer is a claim for credit or refund of an overpayment of tax and is subject to the statute of limitations provided in section 6511. A taxpayer's claim for look-back interest (or interest payable on look-back interest) that is not attributable to an amount previously paid by or collected from a taxpayer is a general, non-tax claim against the federal government. For guidance on the statute of limitations that applies to general, non-tax claims against the federal government, see 28 U.S.C. sections 2401 and 2501. For guidance applicable to the compounding of interest when the look-back interest

is not paid, see sections 6601 to 6622.
* * * * *

§§1.460–7 and 1.460–8 [Removed]

Par. 10. Sections 1.460–7 and 1.460–8 are removed.

§1.471–10 [Amended]

Par. 11. Section 1.471–10 is amended by removing the language "§1.451–3" and adding "§1.460–2" in its place.

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 12. The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 14. In §602.101, paragraph (b) is amended by:

1. Removing the entry for "1.451–3".

2. The following entries are added in numerical order to the table to read as follows:

§602.101 OMB Control numbers.

* * * * *

(b) * * *

CFR part or section where identified and described	Current OMB control No.
* * * * *	
1.460–1	1545–1650
* * * * *	

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

Approved December 20, 2000.

Jonathan Talisman,
Acting Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on January 10, 2001, 8:45 a.m., and published in the issue of the Federal Register for January 11, 2001, 66 F.R. 2219)

Section 472.—Last-In, First-Out Inventories

26 CFR 1.472–1: Last-in, first-out inventories.

Optional dollar-value LIFO inventory computation method for used vehicle dealers. See Rev. Proc. 2001–23, page 784.

Section 481.—Adjustments Required by Changes in Method of Accounting

26 CFR 1.481–1: Adjustments in general.

Method of accounting for cash advances paid to insurance agents is effected on a cut-off basis. See Rev. Proc. 2001–24, page 788.

26 CFR 1.481–4: Adjustments taken into account with consent.

Method of accounting for cash advances paid to insurance agents is effected on a cut-off basis. See Rev. Proc. 2001–24, page 788.

Section 807.—Rules for Certain Reserves

Insurance companies; interest rate tables. Prevailing state assumed interest rates are provided for the determination of reserves under section 807 of the Code for contracts issued in 2000 and 2001. Rev. Rul. 92–19 supplemented in part.

Rev. Rul. 2001-11

For purposes of § 807(d)(4) of the Internal Revenue Code, for taxable years beginning after December 31, 1999, this ruling supplements the schedules of prevailing state assumed interest rates set forth in Rev. Rul. 92-19, 1992-1 C.B. 227. This information is to be used by insurance companies in computing their reserves for (1) life insurance and supplementary total and permanent disability benefits, (2) individual annuities and pure endowments, and (3) group annuities and pure endowments. As § 807(d)(2)(B) requires that the interest rate used to compute these reserves be the greater of (1) the applicable federal interest rate, or (2) the prevailing state assumed interest rate, the table of applicable federal interest rates in Rev. Rul. 92-19 is also supplemented.

Following are supplements to schedules A, B, C, and D to Part III of Rev. Rul. 92-19, providing prevailing state assumed interest rates for insurance products with different features issued in 2000 and 2001, and a supplement to the table in Part IV of Rev. Rul. 92-19, providing the applicable federal interest rate under § 807(d) for 2000 and 2001. This ruling does not supplement Parts I and II of Rev. Rul. 92-19.

This is the ninth supplement to the interest rates provided in Rev. Rul. 92-19. Earlier supplements were published in Rev. Rul. 93-58, 1993-2 C.B. 241 (interest rates for insurance products issued in 1992 and 1993), Rev. Rul. 94-11, 1994-1 C.B. 196 (1993 and 1994), Rev. Rul. 95-4, 1995-1 C.B. 141 (1994 and 1995), Rev. Rul. 96-2, 1996-1 C.B. 141 (1995 and 1996), Rev. Rul. 97-2, 1997-1 C.B. 134 (1996 and 1997), Rev. Rul. 98-2, 1998-1 C.B. 259 (1997 and 1998), Rev. Rul. 99-10, 1999-10 I.R.B. 10 (1998 and 1999), and Rev. Rul. 2000-17, 2000-13 I.R.B. 842 (1999 and 2000).

Part III. Prevailing State Assumed Interest Rates — Products Issued in Years After 1982.*

Schedule A

STATUTORY VALUATION INTEREST RATES
BASED ON THE 1980 AMENDMENTS TO THE
NAIC STANDARD VALUATION LAW

A. Life insurance valuation:

Guarantee Duration (years)	Calendar Year of Issue
	2001
10 or fewer	5.00**
More than 10 but not more than 20	4.75**
More than 20	4.50**

Source: Rates calculated from the monthly averages, ending June 30, 2000, of Moody's Corporate Bond Yield Average — Monthly Average Corporates.

** As the applicable federal interest rate for 2001 of 6.00 percent exceeds this prevailing state assumed interest rate, the interest rate to be used for this product under § 807 is 6.00 percent.

* The terms used in the schedules in this ruling and in Part III of Rev. Rul. 92-19 are those used in the Standard Valuation Law; the terms are defined in Rev. Rul. 92-19.

Part III, Schedule B

STATUTORY VALUATION INTEREST RATES
BASED ON THE 1980 AMENDMENTS TO THE
NAIC STANDARD VALUATION LAW

B. Single premium immediate annuities and annuity benefits involving life contingencies arising from other annuities with cash settlement options and from guaranteed interest contracts with cash settlement options:

Calendar Year of Issue	Valuation Interest Rate
2000	7.00*

Source: Rates calculated from the monthly averages, ending June 30, 2000, of Moody's Corporate Bond Yield Average — Monthly Average Corporates. The terms used in this schedule are those used in the Standard Valuation Law as defined in Rev. Rul. 92-19.

*As this prevailing state assumed interest exceeds the applicable federal interest rate for 2000 of 6.09 percent, the valuation interest rate of 7.00 percent is to be used for this product under § 807.

Part III, Schedule C18 - 2000

STATUTORY VALUATION INTEREST RATES
BASED ON NAIC STANDARD VALUATION LAW
FOR **2000** CALENDAR YEAR BUSINESS
GOVERNED BY THE 1980 AMENDMENTS

C. Valuation interest rates for other annuities and guaranteed interest contracts that are valued on an issue year basis:

Cash Settlement Options?	Future Interest Guarantee?	Guarantee Duration (years)	Valuation Interest Rate For Plan Type		
			A	B	C
Yes	Yes	5 or fewer	7.00	6.00*	5.50*
		More than 5, but no more than 10	6.75	6.00*	5.50*
		More than 10, but not more than 20	5.75*	5.25*	5.00*
		More than 20	5.00*	4.50*	4.50*
Yes	No	5 or fewer	7.25	6.25	5.75*
		More than 5, but not more than 10	7.00	6.25	5.75*
		More than 10, but not more than 20	6.00*	5.50*	5.25*
		More than 20	5.25*	4.75*	4.75*
No	Yes or No	5 or fewer	7.00	NOT APPLICABLE	
		More than 5, but not more than 10	6.75		
		More than 10, but not more than 20	6.25		
		More than 20	5.25*		

Source: Rates calculated from the monthly averages, ending June 30, 2000, of Moody's Corporate Bond Yield Average — Monthly Average Corporates.

*As the applicable federal interest rate for 2000 of 6.09 percent exceeds this prevailing state assumed interest rate, the interest rate to be used for this product under § 807 is 6.09 percent.

Part III, Schedule D18 - 2000

STATUTORY VALUATION INTEREST RATES
BASED ON NAIC STANDARD VALUATION LAW
FOR **2000** CALENDAR YEAR BUSINESS
GOVERNED BY THE 1980 AMENDMENTS

D. Valuation interest rates for other annuities and guaranteed interest contracts that are contracts with cash settlement options and that are valued on a change in fund basis:

Cash Settlement Options?	Future Interest Guarantee?	Guarantee Duration (years)	Valuation Interest Rate For Plan Type		
			A	B	C
Yes	Yes	5 or fewer	7.75	7.25	5.75*
		More than 5, but no more than 10	7.50	7.25	5.75*
		More than 10, but not more than 20	7.00	6.75	5.50*
		More than 20	6.00*	6.00*	5.00*
Yes	No	5 or fewer	8.00	7.50	6.00*
		More than 5, but not more than 10	7.75	7.50	6.00*
		More than 10, but not more than 20	7.25	7.00	5.75*
		More than 20	6.25	6.25	5.25*

Source: Rates calculated from the monthly averages, ending June 30, 2000, of Moody's Corporate Bond Yield Average — Monthly Average Corporates.

*As the applicable federal interest rate for 2000 of 6.09 percent exceeds this prevailing state assumed interest rate, the interest rate to be used for this product under § 807 is 6.09 percent.

Part IV. Applicable Federal Interest Rates.

TABLE OF
APPLICABLE FEDERAL INTEREST RATES
FOR PURPOSES OF § 807

Year	Interest Rate
2000	6.09
2001	6.00

Sources: Rev. Rul. 99-48, 1999-2 C.B. 600 for the 2000 rate and Rev. Rul. 2000-54, 2000-49 I.R.B. 566 for the 2001 rate.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 92–19 is supplemented by the addition to Part III of that ruling of prevailing state assumed interest rates under § 807 for certain insurance products issued in 2000 and 2001 and is further supplemented by an addition to the table in Part IV of Rev. Rul. 92–19 listing applicable federal interest rates. Parts I and II of Rev. Rul. 92–19 are not affected by this ruling.

DRAFTING INFORMATION

The principal author of this revenue ruling is Ann H. Logan of the Office of Assistant Chief Counsel (Financial Institutions and Products). For further information regarding this revenue ruling contact her at (202) 622-3970 (not a toll-free call).

Part III. Administrative, Procedural, and Miscellaneous

Comments on Research Credit Regulations

Notice 2001-19

On January 3, 2001, the Treasury Department published final regulations (T.D. 8930, 2001–5 I.R.B. 433) relating to the computation of the research credit under § 41(c) and the definition of qualified research under § 41(d) in the Federal Register (66 F.R. 280). These regulations reflect changes to § 41 made by the Tax Reform Act of 1986, the Revenue Reconciliation Act of 1989, the Small Business Job Protection Act of 1996, the Taxpayer Relief Act of 1997, the Tax and Trade Relief Extension Act of 1998, and the Tax Relief Extension Act of 1999.

The Treasury Department and the Internal Revenue Service will review these final regulations. Comments are requested on all aspects of the final regulations with specific comments requested on whether modifications should be made to the documentation requirement contained in § 1.41–4(d). As part of this review, the Treasury Department and the Service will reconsider all comments previously submitted in connection with the finalization of T.D. 8930. Comments should be submitted by April 2, 2001, and sent to: CC:M&SP:RU (T.D. 8930), room 5226, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044. Comments may be hand delivered Monday through Friday between the hours of 8 a.m. and 5 p.m. to CC:M&SP:RU (T.D. 8930), room 5226, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, DC 20044. Alternatively, taxpayers may submit comments electronically via the Internet by selecting the "Tax Regs" option on the IRS Home Page or by submitting comments directly to the IRS Internet site at *http://www.irs.ustreas.gov/tax_regs/regslist.html.* All submissions will be open to public inspection.

Upon the completion of this review, the Treasury Department and the Service will announce changes to the regulations, if any, in the form of proposed regulations. In addition, T.D. 8930 will be revised so that the provisions of the regulations, including any changes to T.D. 8930, will be effective no earlier than the date when the completion of this review is announced, except that the provisions related to internal-use computer software (including any revisions) generally will be applicable for taxable years beginning after December 31, 1985.

Taxpayers may continue to rely on T.D. 8930 during the pendency of this review.

For further information regarding this notice, contact Lisa Shuman of the Office of the Associate Chief Counsel (Passthroughs and Special Industries) at (202) 622-3120 (not a toll-free call).

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26 CFR 601.204: Changes in accounting periods and in methods of accounting.
(Also Part I, §§ 446, 472; 1.446–1, 1.472–1.)

Rev. Proc. 2001–23

SECTION 1. PURPOSE

This revenue procedure provides an alternative last-in, first-out (LIFO) inventory computation method (the Used Vehicle Alternative LIFO Method) for taxpayers that sell used automobiles or used light-duty trucks ("used vehicle dealers"). A used vehicle dealer may change to or adopt the Used Vehicle Alternative LIFO Method. Used vehicle dealers generally may obtain automatic consent to change their method of accounting to the Used Vehicle Alternative LIFO Method by following the procedures in Rev. Proc. 99–49, 1999–2 C.B. 725, (or its successor) as modified by this revenue procedure.

SECTION 2. BACKGROUND

.01 Section 472(a) of the Internal Revenue Code generally provides that taxpayers may use the LIFO inventory method if, among other requirements, the change to, and use of, such method is in accordance with such regulations as the Secretary may prescribe as necessary in order that the use of such method may clearly reflect income.

.02 Section 472(b) and § 1.472–1(a) of the Income Tax Regulations require taxpayers using the LIFO inventory method to treat goods remaining on hand at the close of the taxable year as being: first, those included in the opening inventory of the taxable year, in the order of acquisition and to the extent thereof; and second, those acquired during the taxable year. Section 472(b) and § 1.472–2 require taxpayers using the LIFO method to inventory their goods at cost.

.03 Section 1.472–8(a) provides that any taxpayer may elect to determine the cost of its LIFO inventories under the "dollar-value" LIFO method, provided such method is used consistently and clearly reflects the income of the taxpayer in accordance with the rules of that section.

.04 Section 1.472–8(e)(1) provides for the use of a "link-chain" method of computing the value of a dollar-value LIFO pool if the taxpayer can demonstrate that the use of either an index method or the double-extension method would be impractical or unsuitable in view of the nature of inventory in the dollar-value LIFO pool. Adequate records must be maintained by the taxpayer to support the appropriateness, accuracy, and reliability of a link-chain method.

.05 Section 1.472–3(d) provides that whether or not the taxpayer's application for the adoption and use of the LIFO inventory method should be approved, and whether or not such method, once adopted, may be continued, and the propriety of all computations incidental to the use of such method, will be determined by the Commissioner in connection with the examination of the taxpayer's income tax returns.

.06 Section 446(e) and § 1.446–1(e)(2)(i) provide that, except as otherwise provided, a taxpayer must secure the consent of the Commissioner before changing a method of accounting for federal income tax purposes. Section 1.446–1(e)(3)(ii) authorizes the Commissioner to prescribe administrative procedures setting forth the terms and conditions deemed necessary to permit a taxpayer to obtain consent to change a method of accounting in accordance with § 446(e).

SECTION 3. SCOPE

The Used Vehicle Alternative LIFO Method may be used to value LIFO

inventories of used automobiles and used light-duty trucks. For purposes of this revenue procedure, used automobiles and used light-duty trucks refer to previously titled vehicles and do not include demonstrator vehicles. Light-duty trucks, which are also referred to as class 1, 2, or 3 trucks, are defined for purposes of this revenue procedure as trucks with a gross vehicle weight of 14,000 pounds or less.

SECTION 4. THE USED VEHICLE ALTERNATIVE LIFO METHOD

.01 *In general*.

(1) The Used Vehicle Alternative LIFO Method is a comprehensive link-chain, dollar-value LIFO inventory method encompassing several required sub-methods and special rules that may only be used to value LIFO inventories of used automobiles and used light-duty trucks. In general, a taxpayer using the Used Vehicle Alternative LIFO Method computes a dollar-value LIFO pool index with reference to average base vehicle prices reported in an official used vehicle guide. This optional method of accounting for used vehicle inventories is designed to simplify the dollar-value LIFO computations of used vehicle dealers.

(2) In the opinion of the Commissioner, income will be clearly reflected by utilization of the Used Vehicle Alternative LIFO Method, provided that a taxpayer follows the sub-methods and special rules described in section 4.02 of this revenue procedure and the computational methodology contained in section 4.03. The Used Vehicle Alternative LIFO Method includes, by definition, all of its sub-methods.

(3) The Used Vehicle Alternative LIFO Method will be accepted by the Commissioner as an appropriate method of computing a LIFO inventory index and the use of that index to compute the value of a dollar-value LIFO pool will be accepted as accurate, reliable, and suitable. All computations under the Used Vehicle Alternative LIFO Method, however, are subject to verification upon examination of the used vehicle dealer's income tax returns.

(4) A taxpayer that uses the Used Vehicle Alternative LIFO Method for a trade or business must use this method of accounting to value the entire inventory of used automobiles and used light-duty trucks held by that trade or business. A taxpayer also is required to file (or have previously filed) an election to use the LIFO inventory method, pursuant to the requirements of § 1.472–3, that applies to all of that inventory.

.02 *Sub-methods and special rules*.

(1) *Use of base vehicle prices*. In general, indexes must be computed using prices for base vehicles that best relate, under the guidelines specified in this revenue procedure, to the used vehicles actually held by the taxpayer. Base vehicle is defined for purposes of this revenue procedure as the most relevant combination of (a) a detailed base model description, consisting of model line, body style, and trim level (*e.g.*, Honda Accord 4D Sedan EX), and (b) an associated manufacturer's base model code number that appears in the official used vehicle guide utilized by the taxpayer and relates to a used vehicle held by the taxpayer.

(2) *Use of official used vehicle guides*. For purposes of this revenue procedure, "official used vehicle guides" are defined as those that (a) are widely recognized and utilized in the used vehicle dealer industry for business purposes in the regions involved, and (b) are regularly and consistently used by the taxpayer in valuing inventory for federal income tax purposes. Any change in the particular used vehicle guide utilized by a taxpayer in connection with the Used Vehicle Alternative LIFO Method or any change in the precise manner of its utilization (*e.g.*, a change in the specific guide category that a taxpayer uses to represent vehicles of average condition for purposes of section 4.02(5)(a) of this revenue procedure) represents a change in method of accounting for which the taxpayer must secure the consent of the Commissioner in accordance with the requirements of Rev. Proc. 97–27, 1997–1 C.B. 680 (or its successor).

(3) *LIFO pools*. A taxpayer that uses the Used Vehicle Alternative LIFO Method must establish, for each trade or business that sells used vehicles, a dollar-value LIFO pool for all used automobiles (regardless of manufacturer) and another separate dollar-value LIFO pool for all used light-duty trucks (regardless of manufacturer). Used sport utility vehicles and used hybrid vehicles (*e.g.*, vans and mini-vans) may be included initially in either the used automobile or the used light-duty truck dollar-value LIFO pool; however, once a choice is made, all like vehicles must be similarly treated in subsequent years.

(4) *Determination of the current-year cost of vehicles in ending inventory*. Under the Used Vehicle Alternative LIFO Method, the current-year cost of each used vehicle in ending inventory must be determined in accordance with this section 4.02(4).

(a) *Purchased vehicles*. The current-year cost for each used vehicle purchased includes its purchase price plus reconditioning costs, delivery charges, and all other costs properly allocated to that particular vehicle under the taxpayer's method of accounting (which includes the taxpayer's method of accounting for § 263A costs).

(b) *Trade-in vehicles*. The current-year cost for each used vehicle acquired via trade-in includes its "cost" plus reconditioning costs and all other costs properly allocated to that particular vehicle under the taxpayer's method of accounting (which includes the taxpayer's method of accounting for § 263A costs). The cost of a vehicle acquired via trade-in must be determined by reference to the wholesale price listing, as permitted by Rev. Rul. 67–107, 1967–1 C.B. 115, in an official used vehicle guide for a similarly equipped, comparable base vehicle that reflects the trade-in vehicle's actual mileage and condition. The cost of a trade-in vehicle also must include prices reflected in the guide for installed options and accessories, if any. The official used vehicle guide from which prices are drawn to determine the cost of a trade-in vehicle must be the guide that covers the day of acquisition of that specific vehicle.

(5) *Inventory pool index guidelines*.

(a) *Computation of an inventory pool index*. For each inventory pool, current-year and prior-year base vehicle prices for each used vehicle in ending inventory are totaled and the totals are used to compute a current-year index for the pool under the Used Vehicle Alternative LIFO Method. These base vehicle prices must be determined by reference to prices reported in an official used vehicle guide for comparable base vehicles of the same age and in average

condition, unadjusted for options, accessories, reconditioning costs, or other costs. "Average condition" is defined for purposes of this revenue procedure as the category that best represents a vehicle in average condition in the taxpayer's official used vehicle guide. Thus, although "average" prices would be used for guides in which this category does appear, it would be appropriate to select and use a comparable category, *e.g.*, "clean" prices, in the case of other used vehicle guides in which there is no average category. Current-year indexes for each inventory pool are then multiplied by prior-year cumulative indexes for that pool to compute a current-year cumulative index. Once a current-year cumulative index is computed for each inventory pool using base vehicle prices, that index is then applied to the total current-year cost (as determined under section 4.02(4), including options, accessories, reconditioning costs, and other costs) of all vehicles in the pool at the end of the taxable year in order to determine whether an inventory increment or decrement has occurred.

(b) *Determination of comparable base vehicle prices for index computations*. Current-year base vehicle prices for all vehicles in ending inventory must be determined by reference to the official used vehicle guide covering the last day of the taxpayer's current taxable year for the specific vehicles held in inventory. Prior-year base vehicle prices for comparable vehicles of the same age as those in ending inventory must be determined by reference to the official used vehicle guide covering the last day of the taxpayer's preceding taxable year. (In the case of a short taxable year, see section 4.02(5)(d) of this revenue procedure.) For example, a calendar year 2000 taxpayer that had a *1998 Vehicle X* (a particular model, body style and trim level) in ending inventory would determine associated base vehicle prices for its index computation as follows: the current-year base vehicle price for this vehicle would be the base price (without adjustment for any options, accessories, reconditioning costs, or other costs) for a *1998 Vehicle X* in average condition from the guide covering December 31, 2000; the associated prior-year base vehicle price would be the base price for a *1997 Vehicle X* in average condition (a comparable vehicle of the same age) from the guide covering December 31, 1999.

(c) *Procedure when a prior-year comparable base vehicle listing does not exist*. When no prior-year base vehicle price for a comparable vehicle of the same age as a vehicle in ending inventory appears in the official used vehicle guide covering the last day of the taxpayer's preceding taxable year (*e.g.*, *Vehicle X* was introduced for the first time in the 1998 model year, and thus there was no corresponding *1997 Vehicle X*), current-year base vehicle price must be used as prior-year base vehicle price in index computations. Current-year base vehicle price must also be used as prior-year base vehicle price in the event that a change in wheelbase or trackwidth from one year to the next has occurred for a particular type of vehicle without a corresponding change in the relevant official used vehicle guide combination of detailed base model description and associated manufacturer's base model code number.

(d) *Procedure in the case of a short taxable year*. Under the Used Vehicle Alternative LIFO Method, all current-year indexes must be adjusted in the case of a short taxable year (*i.e.*, a return for a period of less than 12 months). This adjustment involves adjusting the current-year index, as computed on a full year basis, as follows: current-year index for short taxable year = 1 + [(current-year index for full year - 1) x (number of months in short year / 12)]. For example, a calendar year taxpayer that went out of existence on June 30, 2000, would use official used vehicle guides covering December 31, 1999, and December 31, 2000, in its index calculations to compute a full year index for 2000 and then adjust that index by the number of months actually contained in its short taxable year (*i.e.*, six months).

.03 *Computational methodology*. The following methodology must be applied to compute the value of each dollar-value LIFO pool in a used vehicle dealer's ending inventory under the Used Vehicle Alternative LIFO Method:

STEP 1. Using an official used vehicle guide, as defined in section 4.02(2) of this revenue procedure, determine the detailed base model description and associated manufacturer's base model code number combination that applies to each vehicle in ending inventory.

STEP 2. Determine the current-year cost of each vehicle in ending inventory in accordance with section 4.02(4) of this revenue procedure. Then, for each pool, calculate the total current-year cost of all vehicles in ending inventory.

STEP 3. For each vehicle in ending inventory, using the related description and code number from STEP 1, determine current-year and prior-year base vehicle price as indicated in section 4.02(5) of this revenue procedure.

STEP 4. For each pool, calculate the total current-year base vehicle price and the total prior-year base vehicle price for all vehicles in ending inventory by adding the respective numbers from STEP 3. Divide the total current-year base vehicle price of all vehicles by the total prior-year base vehicle price of all vehicles to determine the current-year pool index. In the case of a short taxable year, adjust this index as indicated in section 4.02(5)(d) of this revenue procedure.

STEP 5. For each pool, compute the cumulative index for the current taxable year by multiplying the cumulative index from the immediately preceding taxable year by the current-year index from STEP 4. For the first taxable year in which the Used Vehicle Alternative LIFO Method is used, the cumulative index for the immediately preceding taxable year is 1.00.

STEP 6. For each pool, calculate ending inventory at base-year cost by dividing total current-year cost from STEP 2 by the cumulative index from STEP 5.

STEP 7. For each pool, determine whether there is an inventory increment or decrement by comparing ending inventory at base-year cost for the current year from STEP 6 to beginning inventory at base-year cost (from STEP 6 of the prior-year calculation), or, for the first taxable year in which this method is used, to beginning inventory (as determined under section 5.02(3) of this revenue procedure, if applicable). If ending inventory at base-year cost is greater, there is an increment. Multiply this increment by the cumulative index from STEP 5 to calculate the LIFO value of the increment (*i.e.*, the layer of increment). Alternatively, if ending inventory at base-year cost is less than beginning inventory at base-year cost, a liquidation (also referred to as an

inventory decrement) has occurred. Reduce the prior-year LIFO layers of increment in reverse chronological order until the liquidation is fully absorbed.

STEP 8. For each pool, add together the current year's layer of increment, if any, at current-year cost and the remaining prior years' layers of increment at each prior year's historical current-year cost to compute the total LIFO value of the inventory pool.

SECTION 5. CHANGING TO THE USED VEHICLE ALTERNATIVE LIFO METHOD

.01 *In general*. A change to the Used Vehicle Alternative LIFO Method is a change in method of accounting to which the provisions of § 446 and the regulations thereunder apply.

.02 *Automatic change to the Used Vehicle Alternative LIFO Method*. Except as provided in section 5.03(2) of this revenue procedure (which applies only to certain taxpayers that use the Inventory Price Index Computation (IPIC) method), a used vehicle dealer that wants to change to the Used Vehicle Alternative LIFO Method must follow the automatic change in accounting method provisions in Rev. Proc. 99–49 (or its successor), with the following modifications:

(1) the scope limitations in section 4.02 of Rev. Proc. 99–49 do not apply, provided the change is made for the first or second taxable year ending on or after December 31, 2000, unless the taxpayer's method of valuing its LIFO inventories of used automobiles or used light-duty trucks is an issue pending within the meaning of section 6.01(6) of Rev. Proc. 2000–38, 2000–40 I.R.B. 310. If the taxpayer is under examination, before an appeals office, or before a federal court with respect to any income tax issue, the taxpayer must provide a copy of the Form 3115, *Application for Change in Accounting Metho*d, to the examining agent, appeals officer, or counsel for the government, as appropriate, at the same time that it files the copy of the Form 3115 with the national office;

(2) a change to the Used Vehicle Alternative LIFO Method under the provisions of Rev. Proc. 99–49 must be effected on a cut-off method, which requires that the value of the taxpayer's used automobile and used light-duty truck inventory at the beginning of the year of change must be the same as the value of that inventory at the end of the preceding taxable year, plus cost restorations, if any, required pursuant to section 5.04(5) of this revenue procedure. However, if the taxpayer has previously improperly accounted for a bulk bargain purchase, the taxpayer, as part of a change to the Used Vehicle Alternative LIFO Method, must first change its method of accounting to comply with *Hamilton Industries, Inc. v. Commissioner*, 97 T.C. 120 (1991), and compute a § 481(a) adjustment for that part of the change (*see* Announcement 91–173, 1991–47 I.R.B. 29);

(3) in effecting a change to the Used Vehicle Alternative LIFO Method under Rev. Proc. 99–49, any LIFO inventory cost increments previously determined and the value of those increments must be retained. Instead of using the earliest taxable year for which the taxpayer adopted LIFO as the base year, the year of change must be used as the new base year in determining the value of all existing LIFO cost increments for the year of change and later taxable years. (The cumulative index at the beginning of the year of change will be 1.00.) The base-year cost of all LIFO cost increments at the beginning of the year of change must be restated in terms of new base-year costs, using the year of change as the new base year, and the indexes for previously determined inventory increments must be recomputed accordingly. The new base-year cost of a pool is equal to the total current-year cost of all the vehicles in the pool;

(4) when filing Form 3115, taxpayers are reminded to complete all applicable parts of the form, including Part I of Schedule B, and, in lieu of the label required by section 6.02(3) of Rev. Proc. 99–49, are instructed to write "Filed under Rev. Proc. 2001–23" at the top of the form; and,

(5) taxpayers must comply with the additional conditions stated in section 5.04 of this revenue procedure.

.03 *Procedure for IPIC taxpayers with used vehicles as well as other goods in inventory*.

(1) *Automatic change*. A used vehicle dealer using the IPIC method that also has parts and accessories, new automobiles, or new light-duty trucks in inventory may incorporate a change, using a cut-off method, from IPIC to another acceptable LIFO method for these other goods into the change to the Used Vehicle Alternative LIFO Method for used automobiles and used light-duty trucks made pursuant to this revenue procedure under the provisions of Rev. Proc. 99–49. When changing from IPIC to a dollar-value LIFO method for parts and accessories, new automobiles, or new light-duty trucks, a separate inventory pool must be established for each of these types of inventory.

(2) *Nonautomatic change*. A used vehicle dealer that uses the IPIC method and has in inventory goods other than used automobiles, used light-duty trucks, parts and accessories, new automobiles, and new light-duty trucks must change to the Used Vehicle Alternative LIFO Method under the provisions of Rev. Proc. 97–27 (or its successor). When making the change to the Used Vehicle Alternative LIFO Method, the taxpayer must (a) effect the change using the cut-off method described in section 5.02(2) of this revenue procedure, (b) use the year of change as the new base year, with all LIFO inventory cost increments previously determined and the value of those increments retained, as described in section 5.02(3) of this revenue procedure, (c) attach to its Form 3115 a schedule setting forth the classes of goods for which it had elected to use the LIFO method and was using IPIC, as well as the accounting method changes that are being made for each class of goods, and (d) comply with the conditions stated in section 5.04 of this revenue procedure.

.04 *Conditions of change*. A used vehicle dealer that changes to the Used Vehicle Alternative LIFO Method must comply with the following conditions:

(1) the used vehicle dealer must comply with the requirements incident to the adoption and use of the LIFO inventory method provided in § 1.472–2, including the requirement to keep its books and records for the year of change and for later taxable years on the LIFO inventory method and use the LIFO inventory method for all reports, including consolidated financial statements, if any, and statements for credit purposes, in conformity with the provisions of § 1.472–2(e);

(2) the used vehicle dealer must maintain and retain complete records of index computations under the Used Vehicle Alternative LIFO Method, including relevant used vehicle guides, and complete records of the current-year cost of vehicles held in ending inventory for each open year, including purchase invoices for each vehicle purchased and used vehicle guides used to cost trade-ins consistent with the requirements of § 1.472–8(d);

(3) the used vehicle dealer must combine and/or separate its dollar-value LIFO pool(s) in accordance with § 1.472–8(g)(2) to conform with the pooling requirements of section 4.02(3) of this revenue procedure, including any pool(s) resulting from section 5.04(4) of this revenue procedure;

(4) the used vehicle dealer must convert from a specific-goods LIFO method, if applicable, to the Used Vehicle Alternative LIFO Method in accordance with § 1.472–8(f)(2); and,

(5) the used vehicle dealer must elect to adopt or extend LIFO, and comply with the cost restoration provisions of § 472(d) and § 1.472–3 (*see also* Rev. Rul. 76–282, 1976–2 C.B. 137), for any used automobiles or used light-duty trucks to which a LIFO election did not previously apply but that are required to be included in dollar-value LIFO pools under the Used Vehicle Alternative LIFO Method.

SECTION 6. ELECTING LIFO AND ADOPTING THE USED VEHICLE ALTERNATIVE LIFO METHOD

.01 *In general*. If a used vehicle dealer is required to make an election to adopt or extend LIFO in connection with adoption of the Used Vehicle Alternative LIFO Method, the used vehicle dealer must complete and file a statement of election of the LIFO inventory method on Form 970, *Application to Use LIFO Inventory Method*. The use of the Used Vehicle Alternative LIFO Method should be clearly indicated on the Form 970, or in an attachment thereto, and a reference should be made to this revenue procedure.

.02 *Conditions*. (1) The five year limitation on re-election of LIFO provided in section 10.01(2) of the APPENDIX of Rev. Proc. 99–49 will be waived for affected taxpayers desiring to elect the Used Vehicle Alternative LIFO Method pursuant to this revenue procedure.

(2) A taxpayer electing LIFO and adopting the Used Vehicle Alternative LIFO Method must comply with the conditions stated in section 5.04 of this revenue procedure.

SECTION 7. INQUIRIES

Inquiries regarding this revenue procedure may be addressed to the Commissioner of Internal Revenue, Attention: CC:ITA:7, 1111 Constitution Avenue, N.W., Washington, D.C. 20224.

SECTION 8. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 99–49 is modified and amplified to include this automatic change in section 10 of the APPENDIX.

The APPENDIX of Rev. Proc. 99–49 is modified to provide that the automatic accounting method change provided in section 10.02, which relates to a change in the method of determining the cost of used vehicles purchased or taken as a trade-in, does not apply to taxpayers that have adopted or changed to the Used Vehicle Alternative LIFO Method.

SECTION 9. EFFECTIVE DATE

This revenue procedure is effective for taxable years ending on or after December 31, 2000.

DRAFTING INFORMATION

The principal author of this revenue procedure is Alan J. Tomsic of the Office of Associate Chief Counsel (Income Tax and Accounting). For further information regarding this revenue procedure, contact Mr. Tomsic at (202) 622-4970 (not a toll-free call).

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26 CFR 601.204: Changes in accounting periods and in methods of accounting.
(Also Part 1 , §§ 446, 451, 481; 1.446–1, 1.451–1, 1.481–1, 1.481–4.)

Rev. Proc. 2001–24

SECTION 1. PURPOSE

This revenue procedure provides the procedures by which an insurance company ("Company") may obtain automatic consent to change its method of accounting for cash advances on commissions ("cash advances") paid to its agents from deducting a cash advance in the taxable year paid to the agent to deducting a cash advance in the taxable year earned by the agent ("earned cash advance"). This revenue procedure applies only to cash advances that qualify as loans under this revenue procedure.

SECTION 2. BACKGROUND

.01 *Change in method of accounting defined*. Section 1.446–1(e)(2)(ii)(a) of the Income Tax Regulations provides that a change in method of accounting includes a change in the overall plan of accounting for gross income or deductions, or a change in the treatment of any material item. A material item is any item that involves the proper time for the inclusion of the item in income or the taking of the item as a deduction.

.02 *Securing permission to make a method change*. Sections 446(e) and 1.446–1(e) state that, except as otherwise provided, a taxpayer must secure the consent of the Commissioner before changing a method of accounting for federal income tax purposes. Section 1.446–1(e)(3)(i) requires that, in order to obtain the Commissioner's consent to change a method of accounting, a taxpayer must file a Form 3115, *Application for Change in Accounting Method*, during the taxable year in which the taxpayer wants to make the proposed change. Rev. Proc. 99–49, 1999–2 C.B. 725 provides the procedures by which taxpayers may obtain automatic consent to change certain specified methods of accounting by the filing of a Form 3115 within the time specified for the filing of a tax return for the year of change.

.03 *Terms and conditions of a method change*. Section 1.446–1(e)(3)(ii) authorizes the Commissioner to prescribe administrative procedures setting forth the limitations, terms, and conditions deemed necessary to permit a taxpayer to obtain consent to change a method of accounting

in accordance with §446(e). The terms and conditions the Commissioner may prescribe include the year of change, whether the change is to be made with a §481(a) adjustment or on a cut-off basis, and the §481(a) adjustment period.

SECTION 3. SCOPE

This revenue procedure applies to cash advances paid by the Company to an agent if (and only if) all four of the following conditions are met: (1) the agreement between the Company and the agent states that the cash advance is a "loan"; (2) the Company charges adequate interest on the cash advance during the period it is outstanding; (3) the agent is personally liable for the repayment of the cash advance and payment of any accrued but unpaid interest (that is, the Company's source of repayment is not limited to the agent's earned cash advances); and (4) the Company treats the cash advance as a loan for all federal tax purposes including employment tax purposes.

SECTION 4. CHANGE IN ACCOUNTING METHOD

.01 *In general*. Any change in a Company's method of accounting pursuant to this revenue procedure is a change in method of accounting to which the provisions of §§446 and 481 and the regulations thereunder apply.

.02 *Automatic change for taxpayers within the scope of this revenue procedure*. A Company changing its method of accounting for cash advances meeting the requirements of Section 3 for the first or second taxable year beginning after December 31, 1999 ("year of change") pursuant to the provisions of this revenue procedure must follow the automatic change in accounting method provisions of Rev. Proc. 99–49 (or its successor) with the following modifications:

(1) To both copies of its Form 3115, the Company must attach a statement that complies with the provisions of Section 4.03 of this revenue procedure.

(2) The scope limitations in section 4.02 of Rev. Proc. 99–49 do not apply. However, if the Company is under examination, before an appeals office, or before a federal court regarding any income tax issue, the Company must provide a copy of the Form 3115 to the examining agent, appeals officer, or counsel for the government, as appropriate, at the same time that it files the copy of the Form 3115 with the National Office.

(3) This change is effected on a "cut-off" basis in the year of change, as specified in section 2.06 of Rev. Proc. 99–49. Thus, a §481(a) adjustment is neither required nor permitted. If the Company previously changed its method of accounting for cash advances from "loans" to "earned cash advances" and that change resulted in a §481(a) adjustment that has not been fully included in the Company's taxable income, the Company must include the remaining §481(a) adjustment in taxable income in the year of change. Similarly, if the Company previously changed its method of accounting for cash advances from "loans" to "earned cash advances" and that change resulted in a §481(a) adjustment that has not been fully included in the agent's reported income, the Company must include the remaining §481(a) adjustment on the agent's applicable Form 1099–MISC, *Miscellaneous Income*, or Form W-2, *Wage and Tax Statement*, for the year of change.

.03 *Statement*. The statement referred to in section 4.02 of this revenue procedure should be identified at the top as follows: "CHANGE IN METHOD OF ACCOUNTING UNDER REV. PROC. 2001–24" The statement must include:

(1) a paragraph stating that the Company is changing its method of accounting for cash advances that meet the requirements of section 3 of this Rev. Proc. 2001–24, effective for the year of change and all subsequent tax years, from deducting the cash advances in the taxable year paid to an agent to deducting the cash advances in the taxable year earned by the agent.

(2) a paragraph stating that for the year of change and all subsequent years, the Company will treat cash advances as earned cash advances when the Company incurs a liability to the agent arising from the underlying transaction (e.g., when the Company receives a premium payment from the policy holder who purchased the policy from the agent).

(3) a paragraph stating that for the year of change and all subsequent years, the Company will treat earned cash advances as wages subject to federal employment taxes in the case of an employee agent or as compensation in the case of an independent contractor agent. For this purpose, earned cash advances do not include commissions retained by the Company to recoup cash advances (or interest thereon) that were reported by the Company as earned by the agent in a prior calendar year under the Company's former method of accounting for cash advances.

(4) a paragraph stating that the Company agrees to all the terms and conditions of this Rev. Proc. 2001–24 and Rev. Proc. 99–49.

(5) the signature by, or on behalf of, the Company making the election by an individual with the authority to bind the Company in these matters. Thus, an officer must sign on behalf of a corporation, a general partner must sign on behalf of a state law partnership, a member-manager must sign on behalf of a limited liability company, a trustee must sign on behalf of a trust, and an individual must sign on behalf of a sole proprietorship. If the Company is a member of a consolidated group, the statement submitted on behalf of the Company must be signed by a duly authorized officer of the common parent. See section 6.02(4) of Rev. Proc. 99–49.

.04 *Consent*. Pursuant to §1.446–1(e)(2)(i), the consent of the Commissioner is hereby granted to any Company within the scope of this revenue procedure to change its method of accounting for cash advances, provided the Company complies with all the applicable provisions of this revenue procedure and, to the extent applicable, Rev. Proc. 99–49. Further, agents of a Company changing its method of accounting pursuant to this revenue procedure are granted consent to change their method of accounting to report cash advances meeting the requirements of Section 3 in the year earned rather than in the year paid, so long as their change in method of accounting is consistent with the Company's reporting. No separate filing is required by an agent.

SECTION 5. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 99–49 is modified and amplified to include this automatic change in section 5A of the APPENDIX.

SECTION 6. EFFECTIVE DATE

This revenue procedure is effective for taxable years beginning after December 31, 1999.

SECTION 7. PAPERWORK REDUCTION ACT

The collection of information contained in this revenue procedure has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545–1736.

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.

The collection of information in this revenue procedure is in section 4. This information is required to notify the IRS that the Company is changing its method of accounting for cash advances that meet the requirements of section 3 of this Rev. Proc. 2001–24 under the required terms and conditions. This information will be used to update the IRS's records. The collection of information is required to obtain or retain benefits. The likely respondents are business or other for-profit institutions and small businesses or organizations.

The estimated total annual reporting burden is 1,318 hours.

The estimated annual burden per respondent is 15 minutes.

The estimated number of respondents 5,270.

The estimated annual frequency of responses is once.

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.

DRAFTING INFORMATION

The principal author of this revenue procedure is Leo F. Nolan II of the Office of Associate Chief Counsel (Income Tax and Accounting). For further information regarding this revenue procedure, contact Mr. Nolan at (202) 622-4960 (not a toll-free call).

Part IV. Items of General Interest

Model Amendment for Retirement Plans for Proposed Regulations Under Section 401(a)(9)

Announcement 2001–18

Proposed regulations under § 401(a)(9) of the Internal Revenue Code, relating to required minimum distributions from retirement plans, were published in the Federal Register on January 17, 2001 (the 2001 Proposed Regulations). The 2001 Proposed Regulations are proposed to be effective for distributions for calendar years beginning on or after January 1, 2002. The preamble to the 2001 Proposed Regulations states that taxpayers may rely on regulations under § 401(a)(9) that were proposed in 1987 (the 1987 Proposed Regulations) or on the 2001 Proposed Regulations "[f]or determining required minimum distributions for calendar year 2001." For this purpose, distributions for calendar year 2001 do not include a distribution that is required to be made by April 1, 2001, for calendar year 2000, such as for an IRA owner or retired qualified plan participant who attains age 70 1/2 in 2000. To determine the amount of such a distribution (as in the case of other distributions for calendar years prior to 2001), taxpayers may rely on the 1987 Proposed Regulations.

The preamble to the 2001 Proposed Regulations contains a model amendment for qualified plan sponsors to adopt if they wish to follow the 2001 Proposed Regulations in making distributions for 2001 and subsequent calendar years. The first sentence of the model amendment, as published in the Federal Register on January 17, 2001, referred to distributions made in calendar years beginning on or after January 1, 2000, but was intended to refer instead to distributions made for calendar years beginning on or after January 1, 2001. A correction notice is being submitted to the Office of the Federal Register. The 2001 Proposed Regulations (REG–130477–00 and REG–130481–00), as corrected, will be published in Internal Revenue Bulletin 2001–11 dated March 12, 2001. The correct model amendment reads as follows:

Model Amendment

"With respect to distributions under the Plan made for calendar years beginning on or after January 1, 2001 ***(ALTERNATIVELY, SPECIFY A LATER CALENDAR YEAR FOR WHICH THE AMENDMENT IS TO BE INITIALLY EFFECTIVE)***, the Plan will apply the minimum distribution requirements of section 401(a)(9) of the Internal Revenue Code in accordance with the regulations under section 401(a)(9) that were proposed on January 17, 2001, notwithstanding any provision of the Plan to the contrary. This amendment shall continue in effect until the end of the last calendar year beginning before the effective date of final regulations under section 401(a)(9) or such other date as may be specified in guidance published by the Internal Revenue Service."

Qualified plan sponsors that wish to follow the 2001 Proposed Regulations in making distributions for 2001 and subsequent calendar years should adopt the corrected model amendment as set forth above in lieu of the model amendment as published in the preamble to the 2001 Proposed Regulations in the Federal Register on January 17, 2001. A plan sponsor that adopted the model amendment as published in the Federal Register on January 17, 2001, should amend its plan to substitute the corrected model amendment set forth above for the model amendment that was previously adopted.

CPI Adjustment for Below-Market Loans for 2001; Correction

Announcement 2001–19

As published, Rev. Rul. 2000–56, 2000–52 I.R.B. 597, which lists the inflation-adjusted amounts that a taxpayer may lend to a qualified continuing care facility without incurring imputed interest under § 7872(g) of the Internal Revenue Code for years 1987- 2001, contained a numerical error. Table 1 of Rev. Rul. 2000–56 incorrectly lists the year 2001 inflation-adjusted limit under § 7872(g)(2) as $144,111. Section 7872(g)(5)(A) of the Code requires any increase in the dollar amount of this inflation adjustment to be rounded to the nearest multiple of $100. Accordingly, the corrected year 2001 inflation-adjusted limit under § 7872 (g)(2) contained in Table 1 of Rev. Rul. 2000–56 is $144,100.

The principal author of this announcement is Courtney Shepardson of the Office of Associate Chief Counsel (Financial Institutions and Products). For further information regarding this announcement, contact Ms. Shepardson at (202) 622-3940 (not a toll-free call).

New Simplified Rules for Minimum Required Distributions

Announcement 2001–23

The Service announces supplements to Publication 575, *Pension and Annuity Income*, and Publication 590, *Individual Retirement Arrangements*, that take into account proposed regulations (REG–130477–00; REG–130481–00) substantially simplifying the calculation of minimum required distributions from qualified plans, IRAs, and other related retirement savings vehicles.

Supplement to Publication 575, *Pension and Annuity Income*

New Simplified Rules for Minimum Required Distributions

After Publication 575 was printed, the IRS issued new rules that simplify how minimum required distributions will be figured after 2001. For 2001, the minimum required distribution can be figured using either these new rules or the old rules explained in Publication 575, *Pension and Annuity Income*. For most people, the new simplified rules will result in lower minimum required distributions.

If you are age 70 1/2 or older and participate in a qualified retirement plan or if you are the beneficiary of such a plan, you may be subject to an additional tax if the

amount distributed annually by the plan is less than the minimum required distribution for the year. This additional tax applies to distributions from qualified employee plans, qualified employee annuity plans, section 457 deferred compensation plans, tax-sheltered annuity plans, and individual retirement arrangements (IRAs). The additional tax is discussed in Publication 575 beginning on page 30.

If your required beginning date is April 1, 2001 (either because you attained age 70 1/2 or retired in 2000), and you are taking your minimum required distribution for 2000 by April 1, 2001, do not use the new rules for figuring the distribution for 2000. Instead, use the old rules in Publication 575. Use the new rules for figuring the required distribution for 2001 that must be made by the end of 2001.

For detailed information about the new rules, see the proposed regulations published in the Federal Register on January 17, 2001, 66 F.R. 3928, and Announcement 2001–18 in this Bulletin. The corrected version of the proposed regulations will be in Internal Revenue Bulletin 2001–11 dated March 12, 2001.

Distributions during the employee's lifetime. Under the new rules, minimum required distributions during your lifetime are based on a distribution period that can be determined using a single table and your age. The distribution period is not affected by your beneficiary's age unless your sole beneficiary is your spouse who is more than 10 years younger than you are. In that case you can use a different table.

To figure the minimum required distribution for 2001, divide your account balance at the end of 2000 by the distribution period from the table. You can use the tables in Publication 590, *Individual Retirement Arrangements (IRAs)*, to determine the distribution period. This is the "applicable divisor" listed next to your age (as of your birthday in 2001) in the *Table for Determining Applicable Divisor for MDIB (Minimum Distribution Incidental Benefit)* on page 80 of Publication 590, unless your sole beneficiary is your spouse who is more than 10 years younger than you are. In that case, use the number at the intersection of the ages of you and your spouse (as of your birthdays in 2001) in *Table II (Joint and Last Survivor Expectancy)* beginning on page 76 of Publication 590. These rules also apply for figuring the minimum required distribution for 2001 for an employee who dies in 2001 after his or her required beginning date.

Distributions after the employee's death. Under the new rules, if the designated beneficiary of the employee is an individual, such as the employee's spouse or child, minimum required distributions for years after the year of the employee's death are generally based on a distribution period that can be determined using the beneficiary's single life expectancy. This rule applies whether or not the death occurred before the employee's required beginning date. If the employee's beneficiary is not an individual (for example, if the beneficiary is the employee's estate), the rule for determining minimum required distributions for years after the employee's death depends on whether or not the death occurred before the employee's required beginning date.

If the employee's designated beneficiary is an individual. To figure the minimum required distribution for 2001, divide the account balance at the end of 2000 by the distribution period. You can use *Table I (Single Life Expectancy)* in Publication 590 to determine the distribution period, as follows.

- ***Spouse as sole designated beneficiary.*** The distribution period is the divisor listed in the table next to the spouse's age (as of the spouse's birthday in 2001). If the employee died before the year in which he or she attained age 70 1/2, distributions to the spouse need not begin until the year in which the employee would have attained age 70 1/2.
- ***Other designated beneficiary.*** The distribution period is the divisor listed in the table next to the beneficiary's age (as of his or her birthday in the year following the year of the employee's death), reduced by one for each elapsed year since the year following the employee's death.

If the employee's designated beneficiary is not an individual. Determine the minimum required distribution for 2001 as follows.

- ***Death on or after the required beginning date***. Divide the account balance at the end of 2000 by the distribution period from *Table I (Single Life Expectancy)* on page 75 of Publication 590. The distribution period is the divisor listed next to the employee's age (as of his or her birthday in the year of death), reduced by one for each elapsed year since the year of death.
- ***Death before the required beginning date.*** The 5-year rule continues to apply. Under this rule, the entire account must be distributed by the end of the fifth year following the year of the employee's death. No distribution is required for a year before that fifth year. This rule may also be elected by a beneficiary who is an individual.

Supplement to Publication 590, *Individual Retirement Arrangements (IRAs)*

New Simplified Rules for Minimum Required Distributions

After Publication 590 was printed, the IRS issued new rules that simplify how minimum required distributions will be figured after 2001. For 2001, you can figure the minimum required distribution using either these new rules or the old rules explained in Publication 590, *Individual Retirement Arrangements (IRAs)*. For most people, the new simplified rules will result in lower minimum required distributions.

If you are age 70 1/2 or older and own a traditional IRA or if you are the beneficiary of an IRA, you may be subject to an additional tax if you do not take annual distributions from the IRA of at least the minimum required distribution for the year. This is discussed in Publication 590 beginning on page 21, under *When Must I Withdraw IRA Assets? (Required Distributions).*

If you attained age 70 1/2 in 2000 and are taking your minimum required distribution for 2000 by April 1, 2001, do not use the new rules for figuring the distribution for 2000. Instead, use the old rules in Publication 590. Use the new rules for figuring the required distribution for 2001 that must be made by the end of 2001.

For detailed information about the new rules, see the proposed regulations published in the Federal Register on January 17, 2001, 66 F.R. 3928, and Announcement 2001–18 in this Bulletin. The corrected version of the proposed regulations will be in Internal Revenue Bulletin 2001–11 dated March 12, 2001.

Distributions during the owner's lifetime. Under the new rules, minimum

required distributions during your lifetime are based on a distribution period that can be determined using a single table and your age. The distribution period is not affected by your beneficiary's age unless your sole beneficiary is your spouse who is more than 10 years younger than you are. In that case, you can use a different table.

To figure the minimum required distribution for 2001, divide your account balance at the end of 2000 by the distribution period from the table. This is the "applicable divisor" listed next to your age (as of your birthday in 2001) in the *Table for Determining Applicable Divisor for MDIB (Minimum Distribution Incidental Benefit)* on page 80 of Publication 590, unless your sole beneficiary is your spouse who is more than 10 years younger than you are. In that case, use the number at the intersection of the ages of you and your spouse (as of your birthdays in 2001) in *Table II (Joint and Last Survivor Expectancy)* beginning on page 76 of Publication 590. These rules also apply for figuring the minimum required distribution for 2001 for an owner who dies in 2001 after his or her required beginning date.

Distributions after the owner's death. Under the new rules, if the designated beneficiary of the owner is an individual, such as the owner's spouse or child, minimum required distributions for years after the year of the owner's death generally are based on a distribution period that can be determined using the beneficiary's single life expectancy. This rule applies whether or not the death occurred before the owner's required beginning date. If the owner's beneficiary is not an individual (for example, if the beneficiary is the owner's estate), the rule for determining minimum required distributions for years after the owner's death depends on whether or not the death occurred before the owner's required beginning date.

If the owner's designated beneficiary is an individual. To figure the minimum required distribution for 2001, divide the account balance at the end of 2000 by the distribution period from *Table I (Single Life Expectancy)* on page 75 of Publication 590. Determine the distribution period as follows.

- ***Spouse as sole designated beneficiary.*** The distribution period is the divisor listed in the table next to the spouse's age (as of the spouse's birthday in 2001). If the owner died before the year in which he or she attained age 70 1/2, distributions to the spouse need not begin until the year in which the owner would have attained age 70 1/2.
- ***Other designated beneficiary.*** The distribution period is the divisor listed in the table next to the beneficiary's age (as of his or her birthday in the year following the year of the owner's death), reduced by one for each elapsed year since the year following the owner's death.

If the owner's beneficiary is not an individual. Determine the minimum required distribution for 2001 as follows.

- ***Death on or after the required beginning date.*** Divide the account balance at the end of 2000 by the distribution period from *Table I (Single Life Expectancy)* on page 75 of Publication 590. The distribution period is the divisor listed next to the owner's age (as of his or her birthday in the year of death), reduced by one for each elapsed year since the year of death.
- ***Death before the required beginning date.*** The 5-year rule continues to apply. Under this rule, the entire account must be distributed by the end of the fifth year following the year of the owner's death. No distribution is required for a year before that fifth year. This rule may also be elected by a beneficiary who is an individual.

Election to Treat Trust as Part of an Estate; Hearing

Announcement 2001–24

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Change of date of public hearing; extension of time to submit outlines of oral comments.

SUMMARY: This document changes the date of the public hearing on the proposed regulations (REG–106542–98, 2001–5 I.R.B. 473) that relate to an election to have certain revocable trusts treated and taxed as part of an estate. It also extends the time to submit outlines of oral comments for the hearing.

DATES: The public hearing will be held April 11, 2001, beginning at 10 a.m. Additional outlines of oral comments must be received by March 21, 2001.

ADDRESSES: The public hearing will be held in the Auditorium, Internal Revenue Building, 1111 Constitution Avenue, NW., Washington, DC. Send submissions to: Regulations Unit CC (REG–106542–98), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered between the hours of 8 a.m. and 5 p.m. to: Regulations Unit CC (REG–106542–98), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue NW., Washington DC. Alternatively, taxpayers may submit outlines of oral comments electronically directly to the IRS Internet site at http://www.irs.gov/tax_regs/reglist.html.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Faith Colson, (202) 622-3060; concerning submissions, LaNita Van Dyke, (202) 622-7190 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

A notice of proposed rulemaking and notice of public hearing, appearing in the **Federal Register** on Monday, December 18, 2000 (65 F.R. 79015), announced that a public hearing on the proposed regulations relating to an election to have certain revocable trusts treated and taxed as part of an estate would be held on February 21, 2001, in the IRS Auditorium, Internal Revenue Building 1111 Constitution Avenue, NW., Washington, DC. Subsequently, the date of the public hearing has changed to April 11, 2001, at 10 a.m. in the IRS Auditorium. Outlines of oral comments must be received by March 21, 2001.

Cynthia Grigsby,
Chief, Regulations Unit,
Office of Special Counsel
(Modernization & Strategic Planning).

(Filed by the Office of the Federal Register on February 7, 2001, 8:45 a.m., and published in the issue of the Federal Register for February 8, 2001, 66 F.R. 9535)

Definition of Terms

Revenue rulings and revenue procedures (hereinafter referred to as "rulings") that have an effect on previous rulings use the following defined terms to describe the effect:

Amplified describes a situation where no change is being made in a prior published position, but the prior position is being extended to apply to a variation of the fact situation set forth therein. Thus, if an earlier ruling held that a principle applied to A, and the new ruling holds that the same principle also applies to B, the earlier ruling is amplified. (Compare with *modified*, below).

Clarified is used in those instances where the language in a prior ruling is being made clear because the language has caused, or may cause, some confusion. It is not used where a position in a prior ruling is being changed.

Distinguished describes a situation where a ruling mentions a previously published ruling and points out an essential difference between them.

Modified is used where the substance of a previously published position is being changed. Thus, if a prior ruling held that a principle applied to A but not to B, and the new ruling holds that it applies to both A and B, the prior ruling is modified because it corrects a published position. (Compare with *amplified* and *clarified*, above).

Obsoleted describes a previously published ruling that is not considered determinative with respect to future transactions. This term is most commonly used in a ruling that lists previously published rulings that are obsoleted because of changes in law or regulations. A ruling may also be obsoleted because the substance has been included in regulations subsequently adopted.

Revoked describes situations where the position in the previously published ruling is not correct and the correct position is being stated in the new ruling.

Superseded describes a situation where the new ruling does nothing more than restate the substance and situation of a previously published ruling (or rulings). Thus, the term is used to republish under the 1986 Code and regulations the same position published under the 1939 Code and regulations. The term is also used when it is desired to republish in a single ruling a series of situations, names, etc., that were previously published over a period of time in separate rulings. If the new ruling does more than restate the substance of a prior ruling, a combination of terms is used. For example, *modified* and *superseded* describes a situation where the substance of a previously published ruling is being changed in part and is continued without change in part and it is desired to restate the valid portion of the previously published ruling in a new ruling that is self contained. In this case the previously published ruling is first modified and then, as modified, is superseded.

Supplemented is used in situations in which a list, such as a list of the names of countries, is published in a ruling and that list is expanded by adding further names in subsequent rulings. After the original ruling has been supplemented several times, a new ruling may be published that includes the list in the original ruling and the additions, and supersedes all prior rulings in the series.

Suspended is used in rare situations to show that the previous published rulings will not be applied pending some future action such as the issuance of new or amended regulations, the outcome of cases in litigation, or the outcome of a Service study.

Abbreviations

The following abbreviations in current use and formerly used will appear in material published in the Bulletin.

A—Individual.
Acq.—Acquiescence.
B—Individual.
BE—Beneficiary.
BK—Bank.
B.T.A.—Board of Tax Appeals.
C—Individual.
C.B.—Cumulative Bulletin.
CFR—Code of Federal Regulations.
CI—City.
COOP—Cooperative.
Ct.D.—Court Decision.
CY—County.
D—Decedent.
DC—Dummy Corporation.
DE—Donee.
Del. Order—Delegation Order.
DISC—Domestic International Sales Corporation.
DR—Donor.
E—Estate.
EE—Employee.
E.O.—Executive Order.
ER—Employer.
ERISA—Employee Retirement Income Security Act.
EX—Executor.
F—Fiduciary.
FC—Foreign Country.
FICA—Federal Insurance Contributions Act.
FISC—Foreign International Sales Company.
FPH—Foreign Personal Holding Company.
F.R.—Federal Register.
FUTA—Federal Unemployment Tax Act.
FX—Foreign Corporation.
G.C.M.—Chief Counsel's Memorandum.
GE—Grantee.
GP—General Partner.
GR—Grantor.
IC—Insurance Company.
I.R.B.—Internal Revenue Bulletin.
LE—Lessee.
LP—Limited Partner.
LR—Lessor.
M—Minor.
Nonacq.—Nonacquiescence.
O—Organization.
P—Parent Corporation.
PHC—Personal Holding Company.
PO—Possession of the U.S.
PR—Partner.
PRS—Partnership.
PTE—Prohibited Transaction Exemption.
Pub. L.—Public Law.
REIT—Real Estate Investment Trust.
Rev. Proc.—Revenue Procedure.
Rev. Rul.—Revenue Ruling.
S—Subsidiary.
S.P.R.—Statements of Procedural Rules.
Stat.—Statutes at Large.
T—Target Corporation.
T.C.—Tax Court.
T.D.—Treasury Decision.
TFE—Transferee.
TFR—Transferor.
T.I.R.—Technical Information Release.
TP—Taxpayer.
TR—Trust.
TT—Trustee.
U.S.C.—United States Code.
X—Corporation.
Y—Corporation.

Numerical Finding List[1]

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Key to Abbreviations:

Ann	Announcement
CD	Court Decision
DO	Delegation Order
EO	Executive Order
PL	Public Law
PTE	Prohibited Transaction Exemption
RP	Revenue Procedure
RR	Revenue Ruling
SPR	Statement of Procedural Rules
TC	Tax Convention
TD	Treasury Decision
TDO	Treasury Department Order

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