

respect to which the taxpayer has made the election.

**(3) Period to which election applies**

An election under this section shall be effective for the taxable year for which it is made and for all subsequent taxable years, unless the taxpayer secures the consent of the Secretary to the revocation of such election.

**(4) Treatment as method of accounting**

Except to the extent inconsistent with the provisions of this section, for purposes of this subtitle, the computation of taxable income under an election made under this section shall be treated as a method of accounting.

**(d) 5-year spread of transitional adjustments for magazines**

In applying section 481(c) with respect to any election under this section which applies to magazines, the period for taking into account any decrease in taxable income resulting from the application of section 481(a)(2) shall be the taxable year for which the election is made and the 4 succeeding taxable years.

**(e) Suspense account for paperbacks and records**

**(1) In general**

In the case of any election under this section which applies to paperbacks or records, in lieu of applying section 481, the taxpayer shall establish a suspense account for the trade or business for the taxable year for which the election is made.

**(2) Initial opening balance**

The opening balance of the account described in paragraph (1) for the first taxable year to which the election applies shall be the largest dollar amount of returned merchandise which would have been taken into account under this section for any of the 3 immediately preceding taxable years if this section had applied to such preceding 3 taxable years. This paragraph and paragraph (3) shall be applied by taking into account only amounts attributable to the trade or business for which such account is established.

**(3) Adjustments in suspense account**

At the close of each taxable year the suspense account shall be—

**(A) reduced the excess (if any) of—**

(i) the opening balance of the suspense account for the taxable year, over

(ii) the amount excluded from gross income for the taxable year under subsection (a), or

**(B) increased (but not in excess of the initial opening balance) by the excess (if any) of—**

(i) the amount excluded from gross income for the taxable year under subsection (a), over

(ii) the opening balance of the account for the taxable year.

**(4) Gross income adjustments**

**(A) Reductions excluded from gross income**

In the case of any reduction under paragraph (3)(A) in the account for the taxable

year, an amount equal to such reduction shall be excluded from gross income for such taxable year.

**(B) Increases added to gross income**

In the case of any increase under paragraph (3)(B) in the account for the taxable year, an amount equal to such increase shall be included in gross income for such taxable year.

If the initial opening balance exceeds the dollar amount of returned merchandise which would have been taken into account under subsection (a) for the taxable year preceding the first taxable year for which the election is effective if this section had applied to such preceding taxable year, then an amount equal to the amount of such excess shall be included in gross income for such first taxable year.

**(5) Subchapter C transactions**

The application of this subsection with respect to a taxpayer which is a party to any transaction with respect to which there is nonrecognition of gain or loss to any party to the transaction by reason of subchapter C shall be determined under regulations prescribed by the Secretary.

(Added Pub. L. 95-600, title III, § 372(a), Nov. 6, 1978, 92 Stat. 2660.)

**EFFECTIVE DATE**

Section 372(c) of Pub. L. 95-600 provided that: "The amendments made by this section [enacting this section] shall apply to taxable years beginning after September 30, 1979."

**§ 460. Special rules for long-term contracts**

**(a) Requirement that percentage of completion method be used**

In the case of any long-term contract, the taxable income from such contract shall be determined under the percentage of completion method (as modified by subsection (b)).

**(b) Percentage of completion method**

**(1) Requirements of percentage of completion method**

Except as provided in paragraph (3), in the case of any long-term contract with respect to which the percentage of completion method is used—

**(A)** the percentage of completion shall be determined by comparing costs allocated to the contract under subsection (c) and incurred before the close of the taxable year with the estimated total contract costs, and

**(B)** upon completion of the contract (or, with respect to any amount properly taken into account after completion of the contract, when such amount is so properly taken into account), the taxpayer shall pay (or shall be entitled to receive) interest computed under the look-back method of paragraph (2).

In the case of any long-term contract with respect to which the percentage of completion method is used, except for purposes of applying the look-back method of paragraph (2), any income under the contract (to the extent

not previously includible in gross income) shall be included in gross income for the taxable year following the taxable year in which the contract was completed. For purposes of subtitle F (other than sections 6654 and 6655), any interest required to be paid by the taxpayer under subparagraph (B) shall be treated as an increase in the tax imposed by this chapter for the taxable year in which the contract is completed (or, in the case of interest payable with respect to any amount properly taken into account after completion of the contract, for the taxable year in which the amount is so properly taken into account).

**(2) Look-back method**

The interest computed under the look-back method of this paragraph shall be determined by—

(A) first<sup>1</sup> allocating income under the contract among taxable years before the year in which the contract is completed on the basis of the actual contract price and costs instead of the estimated contract price and costs,

(B) second, determining (solely for purposes of computing such interest) the overpayment or underpayment of tax for each taxable year referred to in subparagraph (A) which would result solely from the application of subparagraph (A), and

(C) then using the adjusted overpayment rate (as defined in paragraph (7)), compounded daily, on the overpayment or underpayment determined under subparagraph (B).

For purposes of the preceding sentence, any amount properly taken into account after completion of the contract shall be taken into account by discounting (using the Federal mid-term rate determined under section 1274(d) as of the time such amount was properly taken into account) such amount to its value as of the completion of the contract. The taxpayer may elect with respect to any contract to have the preceding sentence not apply to such contract.

**(3) Special rules**

**(A) Simplified method of cost allocation**

In the case of any long-term contract, the Secretary may prescribe a simplified procedure for allocation of costs to such contract in lieu of the method of allocation under subsection (c).

**(B) Look-back method not to apply to certain contracts**

Paragraph (1)(B) shall not apply to any contract—

(i) the gross price of which (as of the completion of the contract) does not exceed the lesser of—

(I) \$1,000,000, or

(II) 1 percent of the average annual gross receipts of the taxpayer for the 3 taxable years preceding the taxable year in which the contract was completed, and

(ii) which is completed within 2 years of the contract commencement date.

For purposes of this subparagraph, rules similar to the rules of subsections (e)(2) and (f)(3) shall apply.

**(4) Simplified look-back method for pass-thru entities**

**(A) In general**

In the case of a pass-thru entity—

(i) the look-back method of paragraph (2) shall be applied at the entity level,

(ii) in determining overpayments and underpayments for purposes of applying paragraph (2)(B)—

(I) any increase in the income under the contract for any taxable year by reason of the allocation under paragraph (2)(A) shall be treated as giving rise to an underpayment determined by applying the highest rate for such year to such increase, and

(II) any decrease in such income for any taxable year by reason of such allocation shall be treated as giving rise to an overpayment determined by applying the highest rate for such year to such decrease, and

(iii) any interest required to be paid by the taxpayer under paragraph (2) shall be paid by such entity (and any interest entitled to be received by the taxpayer under paragraph (2) shall be paid to such entity).

**(B) Exceptions**

**(i) Closely held pass-thru entities**

This paragraph shall not apply to any closely held pass-thru entity.

**(ii) Foreign contracts**

This paragraph shall not apply to any contract unless substantially all of the income from such contract is from sources in the United States.

**(C) Other definitions**

For purposes of this paragraph—

**(i) Highest rate**

The term “highest rate” means—

(I) the highest rate of tax specified in section 11, or

(II) if at all times during the year involved more than 50 percent of the interests in the entity are held by individuals directly or through 1 or more other pass-thru entities, the highest rate of tax specified in section 1.

**(ii) Pass-thru entity**

The term “pass-thru entity” means any—

(I) partnership,

(II) S corporation, or

(III) trust.

**(iii) Closely held pass-thru entity**

The term “closely held pass-thru entity” means any pass-thru entity if, at any time during any taxable year for which there is income under the contract, 50 percent or more (by value) of the beneficial interests

<sup>1</sup> So in original. Probably should be followed by a comma.

in such entity are held (directly or indirectly) by or for 5 or fewer persons. For purposes of the preceding sentence, rules similar to the constructive ownership rules of section 1563(e) shall apply.

**(5) Election to use 10-percent method**

**(A) General rule**

In the case of any long-term contract with respect to which an election under this paragraph is in effect, the 10-percent method shall apply in determining the taxable income from such contract.

**(B) 10-percent method**

For purposes of this paragraph—

**(i) In general**

The 10-percent method is the percentage of completion method, modified so that any item which would otherwise be taken into account in computing taxable income with respect to a contract for any taxable year before the 10-percent year is taken into account in the 10-percent year.

**(ii) 10-percent year**

The term "10-percent year" means the 1st taxable year as of the close of which at least 10 percent of the estimated total contract costs have been incurred.

**(C) Election**

An election under this paragraph shall apply to all long-term contracts of the taxpayer which are entered into during the taxable year in which the election is made or any subsequent taxable year.

**(D) Coordination with other provisions**

**(i) Simplified method of cost allocation**

This paragraph shall not apply to any taxpayer which uses a simplified procedure for allocation of costs under paragraph (3)(A).

**(ii) Look-back method**

The 10-percent method shall be taken into account for purposes of applying the look-back method of paragraph (2) to any taxpayer making an election under this paragraph.

**(6) Election to have look-back method not apply in de minimis cases**

**(A) Amounts taken into account after completion of contract**

Paragraph (1)(B) shall not apply with respect to any taxable year (beginning after the taxable year in which the contract is completed) if—

(i) the cumulative taxable income (or loss) under the contract as of the close of such taxable year, is within

(ii) 10 percent of the cumulative look-back taxable income (or loss) under the contract as of the close of the most recent taxable year to which paragraph (1)(B) applied (or would have applied but for subparagraph (B)).

**(B) De minimis discrepancies**

Paragraph (1)(B) shall not apply in any case to which it would otherwise apply if—

(i) the cumulative taxable income (or loss) under the contract as of the close of each prior contract year, is within

(ii) 10 percent of the cumulative look-back income (or loss) under the contract as of the close of such prior contract year.

**(C) Definitions**

For purposes of this paragraph—

**(i) Contract year**

The term "contract year" means any taxable year for which income is taken into account under the contract.

**(ii) Look-back income or loss**

The look-back income (or loss) is the amount which would be the taxable income (or loss) under the contract if the allocation method set forth in paragraph (2)(A) were used in determining taxable income.

**(iii) Discounting not applicable**

The amounts taken into account after the completion of the contract shall be determined without regard to any discounting under the 2nd sentence of paragraph (2).

**(D) Contracts to which paragraph applies**

This paragraph shall only apply if the taxpayer makes an election under this subparagraph. Unless revoked with the consent of the Secretary, such an election shall apply to all long-term contracts completed during the taxable year for which election is made or during any subsequent taxable year.

**(7) Adjusted overpayment rate**

**(A) In general**

The adjusted overpayment rate for any interest accrual period is the overpayment rate in effect under section 6621 for the calendar quarter in which such interest accrual period begins.

**(B) Interest accrual period**

For purposes of subparagraph (A), the term "interest accrual period" means the period—

(i) beginning on the day after the return due date for any taxable year of the taxpayer, and

(ii) ending on the return due date for the following taxable year.

For purposes of the preceding sentence, the term "return due date" means the date prescribed for filing the return of the tax imposed by this chapter (determined without regard to extensions).

**(c) Allocation of costs to contract**

**(1) Direct and certain indirect costs**

In the case of a long-term contract, all costs (including research and experimental costs) which directly benefit, or are incurred by reason of, the long-term contract activities of the taxpayer shall be allocated to such contract in the same manner as costs are allocated to extended period long-term contracts under section 451 and the regulations thereunder.

**(2) Costs identified under cost-plus and certain Federal contracts**

In the case of a cost-plus long-term contract or a Federal long-term contract, any cost not



68A Stat. 454, as amended, which is classified generally to chapter 23 (§3301 et seq.) of this title. For complete classification of this Act to the Code, see section 3311 of this title and Tables.

#### AMENDMENTS

2001—Subsec. (c). Pub. L. 107-16, §§532(c)(12), 901, temporarily struck out “section 2011(c) (relating to refunds due to credit for State taxes),” after “see”. See Effective and Termination Dates of 2001 Amendment note below.

1956—Subsec. (c). Act June 29, 1956, inserted reference to section 6421 of this title.

Act Apr. 2, 1956, inserted reference to section 6420 of this title.

#### EFFECTIVE AND TERMINATION DATES OF 2001 AMENDMENT

Amendment by Pub. L. 107-16 applicable to estates of decedents dying, and generation-skipping transfers, after Dec. 31, 2004, see section 532(d) of Pub. L. 107-16, set out as a note under section 2011 of this title.

Amendment by Pub. L. 107-16 inapplicable to estates of decedents dying, gifts made, or generation skipping transfers, after Dec. 31, 2012, and the Internal Revenue Code of 1986 to be applied and administered to such estates, gifts, and transfers as if such amendment had never been enacted, see section 901 of Pub. L. 107-16, set out as a note under section 1 of this title.

#### EFFECTIVE DATE OF 1956 AMENDMENT

Amendment by act June 29, 1956, effective June 29, 1956, see section 211 of act June 29, 1956, set out as an Effective Date note under section 4041 of this title.

#### Subchapter C—Determination of Interest Rate; Compounding of Interest

Sec. 6621.	Determination of rate of interest.
6622.	Interest compounded daily.

#### AMENDMENTS

1982—Pub. L. 97-248, title III, §344(b)(3)(A), Sept. 3, 1982, 96 Stat. 636, inserted “; Compounding of Interest” after “Rate” in heading for subchapter C.

Pub. L. 97-248, title III, §344(b)(2), Sept. 3, 1982, 96 Stat. 636, added item 6622.

#### § 6621. Determination of rate of interest

##### (a) General rule

##### (1) Overpayment rate

The overpayment rate established under this section shall be the sum of—

- (A) the Federal short-term rate determined under subsection (b), plus
- (B) 3 percentage points (2 percentage points in the case of a corporation).

To the extent that an overpayment of tax by a corporation for any taxable period (as defined in subsection (c)(3), applied by substituting “overpayment” for “underpayment”) exceeds \$10,000, subparagraph (B) shall be applied by substituting “0.5 percentage point” for “2 percentage points”.

##### (2) Underpayment rate

The underpayment rate established under this section shall be the sum of—

- (A) the Federal short-term rate determined under subsection (b), plus
- (B) 3 percentage points.

##### (b) Federal short-term rate

For purposes of this section—

##### (1) General rule

The Secretary shall determine the Federal short-term rate for the first month in each calendar quarter.

##### (2) Period during which rate applies

##### (A) In general

Except as provided in subparagraph (B), the Federal short-term rate determined under paragraph (1) for any month shall apply during the first calendar quarter beginning after such month.

##### (B) Special rule for individual estimated tax

In determining the addition to tax under section 6654 for failure to pay estimated tax for any taxable year, the Federal short-term rate which applies during the 3rd month following such taxable year shall also apply during the first 15 days of the 4th month following such taxable year.

##### (3) Federal short-term rate

The Federal short-term rate for any month shall be the Federal short-term rate determined during such month by the Secretary in accordance with section 1274(d). Any such rate shall be rounded to the nearest full percent (or, if a multiple of  $\frac{1}{2}$  of 1 percent, such rate shall be increased to the next highest full percent).

##### (c) Increase in underpayment rate for large corporate underpayments

##### (1) In general

For purposes of determining the amount of interest payable under section 6601 on any large corporate underpayment for periods after the applicable date, paragraph (2) of subsection (a) shall be applied by substituting “5 percentage points” for “3 percentage points”.

##### (2) Applicable date

For purposes of this subsection—

##### (A) In general

The applicable date is the 30th day after the earlier of—

- (i) the date on which the 1st letter of proposed deficiency which allows the taxpayer an opportunity for administrative review in the Internal Revenue Service Office of Appeals is sent, or
- (ii) the date on which the deficiency notice under section 6212 is sent.

The preceding sentence shall be applied without regard to any such letter or notice which is withdrawn by the Secretary.

##### (B) Special rules

##### (i) Nondeficiency procedures

In the case of any underpayment of any tax imposed by this title to which the deficiency procedures do not apply, subparagraph (A) shall be applied by taking into account any letter or notice provided by the Secretary which notifies the taxpayer of the assessment or proposed assessment of the tax.

##### (ii) Exception where amounts paid in full

For purposes of subparagraph (A), a letter or notice shall be disregarded if, during