

# Instructions for Form 8697

(Revised February 1989)

## Interest Computation Under the Look-Back Method for Completed Long-Term Contracts

(Section references are to the Internal Revenue Code unless otherwise noted.)

### Paperwork Reduction Act Notice

We ask for this information to carry out the Internal Revenue laws of the United States. We need it to ensure that taxpayers are complying with these laws and to allow us to figure and collect the right amount of interest. You are required to give us this information.

The time needed to complete and file this form will vary depending on individual circumstances. The estimated average time is:

<b>Recordkeeping</b> .....	8 hrs. 37 min.
<b>Learning about the law or the form</b> .....	1 hr. 58 min.
<b>Preparing the form</b> .....	3 hrs. 7 min.
<b>Copying, assembling, and sending the form to IRS</b> .....	16 min.

If you have comments concerning the accuracy of these time estimates or suggestions for making this form more simple, we would be happy to hear from you. You can write to the **Internal Revenue Service**, Washington, DC 20224. Attention: IRS Reports Clearance Officer TR:FP or the **Office of Management and Budget**, Paperwork Reduction Project (1545-1031), Washington, DC 20503.

### Changes You Should Note

The Technical and Miscellaneous Revenue Act of 1988 made several changes affecting Form 8697. Among the changes enacted were: an exception from the look-back method for certain small contracts and home construction contracts (as defined in section 460(e)(6)(A)); application of the look-back method at the entity level to certain pass-through entities; and the requirement to reapply the look-back method when amounts are received or accrued after the contract completion date. Details on several of these changes can be found in these instructions. In addition, other issues affecting the computation of interest under the look-back method have been clarified in the instructions.

### Purpose of Form

Form 8697 is used to figure the interest due or to be refunded under the look-back method of section 460(b)(3) on certain long-term contracts entered into after February 28, 1986, that are accounted for under either the percentage of completion-capitalized cost method or the percentage of completion method. For guidance concerning these methods, see Notice 89-15, 1989-7 I.R.B. 9.

### Who Must File

**General rule.**—Except for certain construction contracts under section 460(e)(1), you must file Form 8697 for each tax year in which a long-term contract entered

into after February 28, 1986, is completed that for Federal income tax purposes has been accounted for under either the percentage of completion-capitalized cost method or the percentage of completion method.

In the case of a pass-through entity (partnership, S corporation, or trust) that is not closely held, the look-back method is applied at the entity level to contracts completed in a tax year for which the due date (including extensions) of the return of the pass-through entity is after November 9, 1988, and with respect to which substantially all of the income from the contract is from U.S. sources. A pass-through entity is considered closely held if, at any time during the tax year for which there is income under the contract, 50% or more (by value) of the beneficial interests in the entity is held directly or indirectly by or for 5 or fewer persons. For this purpose, rules similar to the constructive ownership rules of section 1563(e) apply.

If you were an owner of an interest in a pass-through entity during any year in which a long-term contract was being accounted for under either the percentage of completion-capitalized cost method or the percentage of completion method and that is not subject to the look-back method at the entity level, you must file this form for your tax year that ends with or includes the end of the entity's tax year in which the contract was completed.

**Small contract exception.**—In addition to contracts excepted under section 460(e)(1), the look-back method does not apply to any contract completed within 2 years of the contract start date if the gross price of the contract (as of contract completion) does not exceed the lesser of:

- (a) \$1 million, or
- (b) 1% of the average annual gross receipts of the taxpayer for the 3 tax years before the tax year of contract completion.

See section 460(b)(4)(B) for details.

### When To File

File Form 8697 not later than the date you are required to file your Federal income tax return (including extensions) for your tax year in which one or more long-term contracts are completed (or with respect to any amount received or accrued after contract completion, for the tax year in which such amount is received or accrued). If you were an owner of an interest in a pass-through entity that has completed one or more long-term contracts not subject to the look-back method at the entity level, file Form 8697 for your tax year that ends with or includes the end of the entity's tax year in which the contract was completed. If you received an extension to file your income tax return, attach a copy of the approved (or automatic) extension form that you filed. You do not need to request a separate extension of time to file Form 8697

### Period Covered

Fill in the tax year line at the top of the form to show the tax year of contract completion for which the form is being filed.

If you were an owner of an interest in a pass-through entity that has completed one or more long-term contracts, enter your tax year that ends with or includes the end of the entity's tax year in which the contract was completed.

### Where To File

File Form 8697 with the Internal Revenue Service Center where you are required to file your Federal income tax return. File the form in a separate envelope from that of your income tax return. You should keep a copy of Form 8697 and any attached schedules for your records.

### Amended Form 8697

You are required to file an amended Form 8697 only if the amount shown on line 6 for any prior year changes as a result of an error you made, an income tax examination, or the filing of an amended income tax return. To amend a previously filed Form 8697, file a corrected Form 8697 marked "Amended" in the margin at the top of the form.

### Attachments

If more space is needed, attach separate sheets to the back of Form 8697. Be sure to put the taxpayer's name and identifying number on each sheet.

### Signature

See the instructions for the "Signature" section of your Federal income tax return. You should sign only the Form 8697 in which you complete column (d). See note below.

### Applying the Look-Back Method Under Special Situations

**Change orders.**—A change order with respect to a contract is not treated as a separate contract for purposes of applying the look-back method unless the change order would be treated as a separate contract under the rules for severing and aggregating contracts provided in Regulations section 1.451-3(e). Therefore, if a change order is not treated as a separate contract, that portion of the actual contract price attributable to the change order must be taken into account in allocating contract income to all tax years of the contract, including tax years before the change order was agreed to.

**Treatment of amounts received or accrued after completion of contract.**—If the contract price is revised to reflect amounts received or accrued after the contract completion date as a result of disputes, litigation, or settlements relating to the contract, the look-back method must be applied in the year such amounts are received or accrued, even if no other contract is completed in that year. To properly reflect such amounts, the taxpayer (with respect to any contract) is permitted to:

- (1) Discount such amounts to their value as of the time the contract was completed using the Federal mid-term rate under section 1274(d) as of the time that the amounts were received or accrued, and
- (2) Reduce such amounts by the costs (e.g. legal expenses) paid or incurred by the taxpayer in order to recover such amounts. If

such amounts are discounted, then such costs must also be discounted to their value as of the time that the contract was completed using the Federal mid-term rate under section 1274(d) as of the time that such costs were paid or incurred.

## Specific Instructions

### Name and Address

Enter the name shown on your Federal income tax return for the contract completion year and your current address. If you are an individual filing a joint return with your spouse, also enter your spouse's name as shown on Form 1040.

### A. Identifying number

If you are an individual, enter your social security number. Other filers must use their employer identification number.

### Columns (a), (b), and (c)

Enter at the top of each column the ending month and year for (1) each prior tax year in which you were required to report income from the completed long-term contract(s) or (2) any other tax year affected by such year(s).

**Note:** *If there were more than 3 prior tax years, attach additional Forms 8697 as needed. On the additional Forms 8697 which you do not sign, enter your name, identifying number, and tax year; complete lines 1 through 8 (as applicable), but do not enter totals in column (d). Enter totals only in column (d) of the Form 8697 you sign.*

### Line 2

In each column, show a net increase to income as a positive amount and a net decrease to income as a negative amount.

In figuring the net adjustment to be entered in each column on line 2, be sure to take into account any other income and expense adjustments that may result from the increase (or decrease) to income from long-term contracts (e.g. in the case of an individual, a change to adjusted gross income may affect investment expenses under section 212, medical expenses under section 213, etc.).

Attach a schedule that includes the following information:

(a) Identification of each completed long-term contract by contract number, job name, or any other reasonable method used in your records to identify each contract.

(b) For each contract, report in columns for each prior year: (1) the amount of income previously reported based on estimated contract price and costs, and (2) the amount of income allocable to each prior year based on actual contract price and costs. Total the columns for each prior year and show the net adjustment to income from long-term contracts.

(c) Any other adjustments that result from the change to income from long-term contracts must be identified and the amounts must be shown in the columns for the affected years so that the net adjustment shown in each column on the attached schedule agrees with the amounts shown on line 2.

An owner of an interest in a pass-through entity is not required to provide the detail listed in (a) and (b) above with respect to prior years. The entity should provide the line 2 amounts with Schedule K-1 or on a separate statement for its tax year in which the contracts are completed.

**Note:** *Taxpayers reporting line 2 amounts from more than one Schedule K-1 (or similar statement) must attach a schedule detailing by entity the net change to income from long-term contracts.*

### Lines 4 and 5

The tax liability to be entered on lines 4 and 5 must be reduced by allowable credits (other than refundable credits, e.g. the credit for taxes withheld on wages, the earned income credit, the credit for Federal tax on fuels, etc.), but do not take into account any credit carrybacks to the prior year in computing the amount to enter on lines 4 and 5 (other than carrybacks that must be taken into account to properly compute interest under section 460). Include on lines 4 and 5 any taxes (such as alternative minimum tax) required to be taken into account in the computation of your tax liability (as originally reported or as redetermined).

### Line 6

**Pass-through entities.**—Multiply the amount on line 2 by the 'highest rate of tax' for each prior year shown in column (a), (b), or (c). The "highest rate of tax" is as follows.

**(a) Pass-through entities in which, at all times during the year, more than 50% of the interests in the entity are held by individuals directly or through other pass-through entities:**

- |                                     |       |
|-------------------------------------|-------|
| (1) Tax years beginning before 1987 | 50%   |
| (2) Tax years beginning in 1987     | 38.5% |
| (3) Tax years beginning after 1987  | 28%   |

**(b) All other pass-through entities:**

- |  |     |
|--|-----|
| (1) Tax years ending before July 1, 1987   | 46% |
| (2) Tax years beginning after June 30, 1987  | 34% |
| (3) For other tax years that include July 1, 1987 the rate is computed as follows:                           |     |
| (i) $\frac{\text{Number of days in tax year before 7/1/87}}{\text{Number of days in tax year}} \times 46\%$  |     |
| (ii) $\frac{\text{Number of days in tax year after 6/30/87}}{\text{Number of days in tax year}} \times 34\%$ |     |
| (iii) Add lines (i) and (ii)   |     |

### Lines 7 and 8

For the increase (or decrease) in tax for each prior year, interest due or to be refunded must be computed at the overpayment rate determined under section 6621(a)(1) and compounded on a daily basis from the due date (not including extensions) of the return for the prior year until the earlier of: (1) the due date (not including extensions) of the return for the contract completion year or (2) the date the return for the contract completion year is filed and any income tax due for that year has been fully paid, except as provided below.

**Note:** *If you are filing this form with respect to amounts received or accrued after contract completion, the tax year in which such amounts are received or accrued is deemed to be the contract completion year.*

**Exceptions:**

(1) If a net operating loss, capital loss, or credit carryback is being increased or decreased as a result of the adjustment made to net income from long-term contracts, the interest due or to be refunded must be computed on the increase or decrease in tax attributable to the change to the carryback only from the due date (not including

extensions) of the return for the prior year that generated the carryback and **not** from the due date of the return for the year in which the carryback was absorbed. See section 6611(f).

(2) In the case of a decrease in tax on line 6, if a refund has been allowed for any part of the income tax liability shown on line 5 for any year as a result of a net operating loss, capital loss, or credit carryback to such year and the amount of the refund exceeds the amount on line 4, interest shall be allowed on the amount of such excess only until the due date (not including extensions) of the return for the year in which the carryback arose.

**Note:** *If a different method of interest computation must be used to produce the correct result in your case, use that method and attach an explanation of how the interest was computed.*

Tables of interest factors to compute daily compound interest were published in Rev. Proc. 83-7 1983-1 C.B. 583. Annual interest rates to be compounded daily and the tables that apply for periods through June 30, 1989, are shown in the following table:

Period	Rate	Daily Rate Table in 1983-1 C.B.
Before 6/30/86	10%	Table 16, p. 599
7/1/86-12/31/86	9%	Table 15, p. 598
1/1/87-3/31/87	8%	Table 14, p. 597
4/1/87-6/30/87	8%	Table 14, p. 597
7/1/87-9/30/87	8%	Table 14, p. 597
10/1/87-12/31/87	9%	Table 15, p. 598
1/1/88-3/31/88	10%	Table 16, p. 599
4/1/88-6/30/88	9%	Table 15, p. 598
7/1/88-9/30/88	9%	Table 15, p. 598
10/1/88-12/31/88	10%	Table 16, p. 599
1/1/89-3/31/89	10%	Table 16, p. 599
4/1/89-6/30/89	11%	Table 17 p. 600

For periods beginning after June 30, 1989, use the overpayment rate under section 6621(a)(1) in the revenue rulings published quarterly in the Internal Revenue Bulletin.

### Line 9

Additional interest, compounded daily, is due or will be refunded on the amounts shown on lines 7 and 8 if not paid by the due date (not including extensions) of the return for the contract completion year. If line 7 column (d), is more than line 8, column (d), figure any interest you owe under this provision from the due date (not including extensions) of the return for the contract completion year to the date you paid the interest, using the applicable rates shown in the above table. If line 8, column (d), is more than line 7 column (d), IRS will figure and pay the amount of any interest due to you.

### Line 10

This amount (or the amount refunded by IRS if different) must be reported as interest income on your Federal income tax return for the tax year in which it is received or accrued.

### Line 11

This amount (or the amount computed by IRS if different) is deductible, subject to any applicable limitations under section 163, as interest expense on your Federal income tax return for the tax year in which it is paid or incurred.