

Instructions for Form 8697

(Revised March 1990)

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:

Recordkeeping	8 hrs., 22 min.
Learning about the law or the form	2 hrs., 3 min.
Preparing the form	3 hrs., 13 min.
Copying, assembling, and sending the form to IRS	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, T:FP; or the **Office of Management and Budget**, Paperwork Reduction Project (1545-1031), Washington, DC 20503.

Changes You Should Note

The Revenue Reconciliation Act of 1989 made several changes affecting Form 8697. The method of filing Form 8697 has been changed. If you owe interest, Form 8697 must now be attached to your income tax return, and the interest is treated as an increase to your income tax (except for purposes of computing the estimated tax penalty). However, if interest is to be refunded to you, Form 8697 is filed separately from your income tax return, and IRS will issue the refund to you.

Section 460(b)(5) provides an election to use a new "10-percent method" for long-term contracts that are accounted for under the percentage of completion method and entered into after July 10, 1989. For purposes of the look-back method, the 10-percent method will apply to all such long-term contracts entered into during the tax

year in which the election is made and any subsequent tax years.

General 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)(2) on certain long-term contracts entered into after February 28, 1986, that are accounted for under either the percentage of completion method or the percentage of completion-capitalized cost method. For guidance concerning these methods, see Notice 89-15, 1989-1 C.B. 634.

Who Must File

General rule.—You must file Form 8697 for each tax year in which a long-term contract entered into after February 28, 1986, is completed that you accounted for using either the percentage of completion method or the percentage of completion-capitalized cost method for Federal income tax purposes.

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 is from U.S. sources. A pass-through entity is considered closely held if, at any time during any 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 method or the percentage of completion-capitalized cost 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.

Exception for certain construction contracts.—The look-back method does not apply to:

(a) any home construction contract (as defined in section 460(e)(6)(A)), or

(b) any other construction contract entered into by a taxpayer: (1) who estimates the contract will be completed within two years from the date the contract begins, and (2) whose average annual gross receipts for the three tax years preceding the tax year in which the contract is entered into do not exceed \$10 million. See section 460(e).

Small contract exception.—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)(3)(B) for details.

Filing Instructions

If you owe interest.—Attach Form 8697 to your income tax return. For taxpayers other than partnerships, include the interest due in the amount to be entered for **total tax** (after credits and other taxes) on your return. (For example, 1989 Form 1040, line 55; 1989 Form 1120, Schedule J, line 10, etc.) Write on the dotted line to the left of the entry space "From Form 8697" and the amount of interest due. For partnerships, write "From Form 8697" and the amount of interest due in the bottom margin of the tax return, and attach a check or money order for the full amount payable to "Internal Revenue Service." Write the partnership's employer identification number, daytime phone number, and "Form 8697 Interest" on the check or money order.

If interest is to be refunded to you.— Do NOT attach Form 8697 to your income tax return. Instead, file Form 8697 separately with the Internal Revenue Service Center where your income tax return is required to be filed. File the form in a separate envelope from that of your income tax return. Keep a copy of Form 8697 and any attached schedules for your records.

Sign Form 8697 following the instructions for the “Signature” section of your income tax return. If additional Forms 8697 are needed (to show more than 3 prior tax years), sign only the first Form 8697.

File Form 8697 not later than the date you are required to file your income tax return (including extensions). You do not need to request a separate extension of time to file Form 8697. If you received an extension of time to file your income tax return, attach a copy of the approved (or automatic) extension form that you filed.

Filing a Corrected Form 8697

You are required to file a corrected 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.

When completing line 1 of the corrected Form 8697, follow the instructions on the form, but do not enter the adjusted taxable income from line 3 of the original Form 8697. When completing line 5 of the corrected Form 8697, do **not** include the interest due, if any, from line 10 of the original Form 8697 that was included in your income tax when Form 8697 was filed with your income tax return.

If you owe interest on both the original and corrected Form 8697, file an amended income tax return following the corresponding filing instructions above and the amended return instructions for your income tax return.

If interest is to be refunded to you on both the original and corrected Form 8697, write “Amended” in the margin at the top of the corrected Form 8697, and file it separately following the corresponding filing instructions above.

If you owed interest on your original Form 8697, and interest is to be refunded to you on the corrected Form 8697, you must:

(a) File an amended income tax return showing \$0 interest from Form 8697, and

(b) File the corrected Form 8697 separately (but do not write “Amended” at the top of the form since this will be the first Form 8697 that you filed separately). Follow the corresponding filing instructions above and the amended return instructions for your income tax return.

If there was interest to be refunded to you on the original Form 8697, and you owe interest on the corrected Form 8697, you must:

(a) File the corrected Form 8697 separately (with “Amended” written at the top) showing \$0 interest to be refunded, and

(b) File an amended income tax return and attach the corrected Form 8697. Follow the corresponding filing instructions above and the amended return instructions for your income tax return.

Attachments

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

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 and contract costs 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 properly taken into account after contract completion.—If the contract price or costs are revised to reflect amounts properly taken into account after the contract completion date for any reason, the look-back method must be applied in the year such amounts are properly taken into account, even if no other contract is completed in that year. To properly reflect such amounts, the taxpayer (with respect to any contract) is permitted (but not required) to 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 properly taken into account.

10-percent method.—For purposes of the percentage of completion method, a taxpayer may elect to postpone recognition of income and expense under a long-term contract entered into after July 10, 1989, until the first tax year as of the end of which at least 10% of the **estimated** total contract costs have been incurred. For purposes of the look-back method, the recognition of income and expense must be postponed for such contracts until the first tax year as of the end of which at least 10% of the **actual** total contract costs have been incurred. Therefore, income and expense will be allocated to a different tax year if the first tax year that the 10% threshold is exceeded based on actual costs differs from the first tax year that the 10% threshold is exceeded based on estimated costs. See section 460(b)(5) for more information.

Specific Instructions

Period Covered

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

Name and Address

Enter the name shown on your Federal income tax return for the contract completion year. If you are an individual filing a joint return with your spouse, also enter your spouse’s name as shown on Form 1040. Enter your address only if you are filing this form separately.

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) and

(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 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 first Form 8697.*

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 a change in 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 34% plus the following:

$$\frac{\text{Number of days in tax year before 7/1/87}}{\text{Number of days in tax year}} \times 12\%$$

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:

(a) the due date (not including extensions) of the return for the contract completion year, or

(b) 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 properly taken into account after contract completion, the tax year in which such amounts are properly taken into account is treated as a contract completion year.

Exceptions:

(a) 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).

(b) 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.

Tables of interest factors to compute daily compound interest are published in Rev. Proc. 83-7, 1983-1 C.B. 583. The annual interest rate in effect and the table and corresponding page number in 1983-1 C.B. for periods through June 30, 1990, are shown in the following table:

From	Through	Rate	Table	Page
—	6/30/86	10%	16	599
7/1/86	12/31/86	9%	15	598
1/1/87	3/31/87	8%	14	597
4/1/87	6/30/87	8%	14	597
7/1/87	9/30/87	8%	14	597
10/1/87	12/31/87	9%	15	598
1/1/88	3/31/88	10%	40	624
4/1/88	6/30/88	9%	39	623
7/1/88	9/30/88	9%	39	623
10/1/88	12/31/88	10%	40	624
1/1/89	3/31/89	10%	16	599
4/1/89	6/30/89	11%	17	600
7/1/89	9/30/89	11%	17	600
10/1/89	12/31/89	10%	16	599
1/1/90	3/31/90	10%	16	599
4/1/90	6/30/90	10%	16	599

For periods beginning after June 30, 1990, use the overpayment rate under section 6621(a)(1) in the revenue rulings published quarterly in the Internal Revenue Bulletin.

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.

Line 9

Additional interest to be refunded for periods after the due date of the return, if any, will be computed by IRS and included in your refund. The amount on line 9 (or the amount refunded by IRS if different) must be reported as interest income on your income tax return for the tax year in which it is received or accrued.

Line 10

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 income tax return for the tax year in which it is paid or incurred.