

Look-Back Accounting

OVERVIEW

The 1986 Tax Act required contractors to use the percentage of completion method of accounting, and to apply look-back calculations to contracts lasting more than one year.

Look-back and percentage of completion requirements were intended to serve as a deterrent for income deferral by requiring aerospace and other large contractors to recognize income based on the costs incurred to date.

The look-back rule requires contractors, upon completion of a contract, to “look back” and substitute the actual costs and revenues for the estimated costs and revenues that were used in the percentage of completion calculations.

The contractor calculates the difference between the taxes paid on the previously estimated amounts and what would have been paid on the actual amounts, as well as interest, and determines whether money is either owed by or due to the Department of Treasury.

While look-back may be helpful for a few industries in which it is difficult to anticipate developments in genuine long-term contracts, it unfairly places excessive burdens on the construction industry. Because construction contractors must be extremely accurate in estimating their contracts, look-back accounting does not serve its “watchdog” purpose of catching underreported income, and it rarely results in any monetary gain for the Treasury Department.

A modification to the look-back accounting requirement for long-term contracts was included in the 1997 Taxpayer Relief Act. The provision allows a taxpayer to elect to forego the look-back method to a given contract if, for each prior taxable year, the estimated taxable income (or loss) under the contract is within 10 percent of the actual taxable income (or loss) of the contract. Additionally, the provision allows for one interest rate to apply during each accrual period in a contract.

ABC considers the modification to the look-back accounting requirement for long-term contracts a small, but positive step toward its goal of full repeal.

ABC SUPPORTS

- Repeal of look-back accounting requirements for construction contractors.

ABC OPPOSES

- The countless hours spent on look-back calculations. Look-back calculations can number in the thousands and can take 15 hours to 30 hours to complete for each job open at year-end.
- Construction contractors paying thousands of dollars to comply with look-back requirements, with virtually no monetary impact on the Treasury Department.