Instructions for Form FTB 3834

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

References in these instructions are to the Internal Revenue Code (IRC) as of **January 1, 2005,** and to the California Revenue and Taxation Code (R&TC).

What's New

Increase In Rates – For taxable years beginning on or after January 1, 2009, the maximum personal income tax rate increased to 9.55%.

General Information

In general, California law conforms to the Internal Revenue Code (IRC) as of January 2005. However, there are continuing differences between California and federal law. When California conforms to federal tax law changes, we do not always adopt all of the changes made at the federal level. For more information, go to **ftb.ca.gov** and search for **conformity**. Additional information can be found in FTB Pub. 1001, Supplemental Guidelines to California Adjustments, the instructions for California Schedule CA (540 or 540NR), and the Business Entity tax booklets.

The instructions provided with California tax forms are a summary of California tax law and are only intended to aid taxpayers in preparing their state income tax returns. We include information that is most useful to the greatest number of taxpayers in the limited space available. It is not possible to include all requirements of the California Revenue and Taxation Code (R&TC) in the tax booklets. Taxpayers should not consider the tax booklets as authoritative law.

Registered Domestic Partners (RDP)
For purposes of California income tax, references to a spouse, husband, or wife also refer to a California registered domestic partner (RDP), unless otherwise specified. When we use the initials RDP they refer to both a California registered domestic "partner" and a California registered domestic "partnership," as applicable. For more information on RDPs, get FTB Pub. 737, Tax Information for Registered Domestic Partners.

Round Cents to Dollars
Round cents to the nearest whole dollar. For example, round $50.50 up to $51 or round $25.49 down to $25. If you do not round, the Franchise Tax Board (FTB) will disregard the cents.

Private Mail Box
Include the Private Mail Box (PMB) in the address field. Write "PMB" first, then the box number. Example: 111 Main Street PMB 123.

A Purpose

Use form FTB 3834, Interest Computation Under the Look-Back Method for Completed Long-Term Contracts, to compute the interest due, or to be refunded using the look-back method under IRC 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.

In the year a long-term contract is completed, the look-back method requires the taxpayer to do the following:

- "Look back" to each of the previous years during which the contract work was in progress.
- Compute interest in those years on the difference between the tax that was actually paid and the tax that would have been paid if the taxpayer had known the actual contract price and cost of the completed contract.

B Who Must File

File form FTB 3834, for the following:

- Each taxable year the long-term contract is completed.
- Each taxable year the contract price or contract cost is adjusted for one or more long-term contracts from a prior year.

See the instructions for federal Form 8697, Interest Computation Under the Look-Back Method for Completed Long-Term Contracts, for more information about filing requirements such as how to determine whether the look-back interest computation is required at the entity or ownership level in the case of a pass-through entity (S corporation, estate or trust, partnership, or limited liability company (LLC) classified as a partnership).

C Exceptions

The look-back method does not apply to regular taxable income from the following items:

- Any home construction contract, as defined in IRC Section 460(e)(6)(A).
- Any construction contract entered into:
  (a) that you estimate the contract will be completed within two years from the contract commencement date, and
  (b) where average annual gross receipts for the three taxable years before the taxable year the contract is entered into do not exceed $10 million. See IRC Section 460(e).
- Any contract completed within two years from the contract commencement date, if the gross price of the contract (as of contract completion) does not exceed the **smaller** of any of the following items:
  (a) $1 million.
  (b) One percent of average annual gross receipts for the three tax years before the tax year of contract completion. See IRC Section 460(b)(3)(B) for more information.

De Minimis Exception. You may elect not to apply the look-back method in certain de minimis cases for contracts completed in taxable years beginning on or after January 1, 1998. The look-back method does not apply in the following cases if the election is made:

1. In the completion year if, for each prior contract year, the cumulative taxable income (or loss) actually reported under the contract is within 10% of the cumulative look-back income (or loss). Cumulative income (or loss) is the amount of taxable income (or loss) that you would have reported if you had used actual contract price and costs instead of estimated contract price and costs.
2. In a post-completion year if, as of the close of the post-completion year, the cumulative taxable income (or loss) under the contract is within 10% of the cumulative look-back income (or loss) under the contract as of the close of the most recent year in which the look-back method was applied to the contract (or would have been applied if the election had not been made).

For purposes of item 2, discounting under IRC Section 460(b)(2) does not apply.

To make the election, attach a statement to your timely filed tax return (determined with extensions) for the first taxable year of the election. Write at the top of the statement "NOTIFICATION OF ELECTION UNDER IRC SECTION 460(b)(6)." Include on the statement your name, identification number, and the effective date of the election. Also identify the trades or businesses that involve long-term contracts. Once made, the election applies to all contracts completed during the election year and all later taxable years. The election may not be revoked except with the written consent of the FTB.

Contract commencement date: The first date on which any costs (other than bidding expenses or expenses incurred in connection with negotiating the contract) allocable to the contract are incurred. For more information, see IRC Section 460(g).

D When to File

File form FTB 3834 at the time you are required to file your California tax return (including extensions) for your taxable year in which one or more long-term contracts are completed (or at any other time required by IRC Section 460 or the regulations thereunder).

- Individuals and estates or trusts, sign Side 2 and file form FTB 3834 as a separate return (**do not** attach it to Form 540, California Resident Income Tax Return; Long Form 540NR, California Nonresident or Part-Year Resident Income Tax Return; or Form 541, California Fiduciary Income Tax Return).
- Corporations, S corporations, exempt organizations, partnerships, and LLCs, enter on the appropriate line of their return the interest due or to be refunded and attach form FTB 3834 to their Form 100, California Corporation Franchise or Income Tax Return; Form 100W, California Corporation Franchise or Income Tax Return - Water's-Edge Filers; Form 100S, California S Corporation Franchise or Income Tax Return; Form 109, California Exempt Organization Business Income Tax Return; Form 565, Partnership Return of Income; or Form 568, Limited Liability Company Return of Income. See instructions for Part I, line 9 and line 10. Corporations, S corporations, exempt organizations, partnerships, and LLCs are not required to sign form FTB 3834.

If you owned an interest in a pass-through entity that has completed one or more long-term contracts, file form FTB 3834 for your taxable year that ends with or includes the end of the entity's taxable year in which the contract was completed.

E Period Covered

Fill in the taxable year line at the top of the form to show the year the contract was completed or adjusted.

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

F Alternative Minimum Taxable Income (AMTI)

If you apply the percentage of completion method to income from a long-term contract only for purposes of determining AMTI, apply the look-back method to AMTI in the year of contract completion. This rule applies whether or not you are liable for alternative minimum tax (AMT) for the filing year or for any prior taxable year.

Interest is computed under the look-back method to the extent your total tax liability (including the AMT liability) would have differed if the percentage of completion method had been applied using actual, rather than estimated, contract price and contract costs.

G Amended Form FTB 3834

Individuals and estates or trusts, file an amended form FTB 3834 only if the amount shown on Part I, line 6 or Part II, line 7 for any prior year changes as a result of an error, an income tax examination, or the filing of an amended income tax return. Follow the corresponding filing instructions for Part I, line 9 and line 10.

H Simplified Marginal Impact Method

Treasury Regulation (Treas. Reg.) Section 1.460-6(d) established the simplified marginal impact method for figuring look-back interest. Pass-through entities, as defined in IRC Section 460(b)(4)(C)(ii), that are not closely held **must** use this simplified method. All other taxpayers may elect to use this method for domestic contracts.

A pass-through entity is considered closely held if, at any time during any taxable year for which there is income under the contract, 50% or more (by value) of the beneficial interests in the entity are held (directly or indirectly) by or for five or fewer persons.

Under the simplified method, hypothetical underpayments or overpayments of tax in prior years are figured using an assumed marginal tax rate which is generally the highest statutory rate of tax in effect for each prior year under R&TC Sections 17041 and 23151. This method eliminates the need to refigure your tax liability based on actual contract price and actual contract costs each time the look-back method is applied.

If you elect the simplified method, use the same method in the election year and all later years, unless the FTB consents to a revocation of the election. Use Part II to figure the simplified marginal impact method.

I S Corporations

S corporations using Part II, the Simplified Marginal Impact Method, must complete form FTB 3834 for each completed long-term contract to compute the interest due or to be refunded to the S corporation as a result of the franchise tax imposed on S corporations. An S corporation cannot file form FTB 3834 on behalf of its shareholders. Shareholders of the S corporation, make separate elections and file form FTB 3834 using the applicable individual rates.

J Miscellaneous

If more than three prior years are involved, check the box above Part I, Side 1 of form FTB 3834. Attach additional form(s) FTB 3834 as needed. Enter your name, identifying number, and taxable year. Complete Part I, line 1 through line 8; or Part II, line 1 through line 9; but do not enter totals in column (d). Enter totals **only** in column (d) of the form FTB 3834 that you sign.

Follow the instructions for federal Form 8697, Interest Computation Under the Look-Back Method for Completed Long-Term Contracts, when applying the look-back method under these special situations:

- Change orders.
- Treatment of amounts properly taken into account after contract completion.
- The delayed reapplication method.
- The 10% method.

Specific Line Instructions

Part I — Regular Method

Use Part I only if you are not electing, do not have an election in effect, or are not required to use the simplified marginal impact method as described in General Information H, Simplified Marginal Impact Method.

Columns (a), (b), and (c) – At the top of each column, enter the ending month and year for each prior taxable year in which you were required to report income from the completed long-term contract(s) and for any other year affected.

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. For apportioning taxpayers, the net increase or net decrease to income is after apportionment. For more information, see Cal. Code Regs., tit. 18 section 25137-2.

In figuring the net adjustment to enter 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. For example, in the case of an individual, a change to adjusted gross income may affect investment expenses and medical expenses under R&TC Section 17201; in the case of a corporation, the apportionment percentage may be affected by a change in the gross receipts included in the sales factor.

Attach separate schedules for regular taxable income or net income and AMTI that include the following:

- 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.
- The amount of income previously reported for each contract based on estimated contract price and costs for each prior year.
- The amount of income for each contract allocable to each prior year based on actual contract price and costs.
- The net adjustment to income from long-term contracts for each prior year.
- Any other adjustments that result from the change to income from long-term contracts.

An owner of an interest in a pass-through entity is not required to provide the detail listed in the first three items above with respect to prior years. The entity should provide the line 2 amounts on Schedule K-1 (100S, 541, 565, or 568), Share of Income, Deductions, Credits, etc., or on a separate statement for its taxable year in which the contracts are completed or adjusted.

If you are reporting line 2 amounts from more than one Schedule K-1 (100S, 541, 565, or 568) or similar statement, you must attach a schedule detailing by entity the net change to income from long-term contracts.

Net Adjustment

California law requires taxpayers to make an adjustment to income upon completion of a contract to correct any underreporting or overreporting of income resulting from differences between state and federal law for the taxable year in which the contract began. This adjustment may be necessary:

For a contract entered into after:	During a taxable year beginning before:
February 28, 1986	January 1, 1987
October 13, 1987	January 1, 1990
June 20, 1988	January 1, 1990
July 10, 1989	January 1, 1990

For purposes of the look-back method, include this adjustment amount in the amount entered on line 2 for the taxable year from which the adjustment arose. Attach a schedule showing your computation.

Prepare the schedule in 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.

Line 4 and Line 5 – Reduce the tax on line 4 and line 5 (but not below the minimum franchise tax) by allowable credits (other than refundable credits). Include any taxes (such as AMT) required to be taken into account in the computation of your tax liability determined as of the latest of the following:

- The original due date.
- The date of an amended or adjusted return.
- The last previous application of the look-back method.

See Treas. Reg. Section 1.460-6(c)(3)(iii) for exceptions and further explanation.

Line 7 and Line 8 – For an increase (or decrease) in tax for each prior year, interest due or to be refunded must be compounded on a daily basis from the due date (not including extensions) of the return for the prior year until the earlier of the following:

- The due date (not including extensions) of the return for the contract completion year.
- The date the return for the contract completion year is filed and any tax due for that year has been fully paid.

Contracts Completed in Taxable Years Ending Before January 1, 2009

Note: The chart for the Corporate Overpayment Rates is on the next page.

For contracts completed in taxable years ending before January 1, 2009, the interest rates to be compounded daily are:

Period	Rate
July 1, 1989, through December 31, 1989	12%
January 1, 1990, through June 30, 1991	11%
July 1, 1991, through June 30, 1992	10%
July 1, 1992, through December 31, 1992	9%
January 1, 1993, through June 30, 1993	8%
July 1, 1993, through December 31, 1994	7%
January 1, 1995, through June 30, 1995	8%
July 1, 1995, through December 31, 1998	9%
January 1, 1999, through June 30, 1999	8%
July 1, 1999, through December 31, 1999	7%
January 1, 2000, through December 31, 2000	8%
January 1, 2001, through December 31, 2001	9%
January 1, 2002, through June 30, 2002	7%
July 1, 2002, through June 30, 2003	6%
July 1, 2003, through June 30, 2004	5%
July 1, 2004, through June 30, 2005	4%
July 1, 2005, through December 31, 2005	5%
January 1, 2006, through June 30, 2006	6%
July 1, 2006, through December 31, 2006	7%
January 1, 2007, through June 30, 2008	8%
July 1, 2008, through December 31, 2008	7%
January 1, 2009, through June 30, 2009	5%
July 1, 2009, through December 31, 2009	5%

Corporate Overpayment Rates

Use the chart shown below to compute corporate overpayments. Beginning July 1, 2002, the interest allowed on corporate overpayments differs from personal income tax overpayments.

Period	Corporate Overpayment Rate
July 1, 2002, through June 30, 2003	2%
July 1, 2003, through June 30, 2005	1%
July 1, 2005, through December 31, 2005	2%
January 1, 2006, through June 30, 2006	3%
July 1, 2006, through December 31, 2006	4%
January 1, 2007, through June 30, 2008	5%
July 1, 2008, through December 31, 2008	3%
January 1, 2009, through June 30, 2009	2%
July 1, 2009, through December 31, 2009	0%

Contracts Completed in Taxable Years Beginning On or After January 1, 2009

For contracts completed in taxable years beginning on or after January 1, 2009, the interest rate is determined for each **interest accrual period**. The interest accrual period starts on the day after the return due date (not including extensions) for each prior taxable year and ends on the return due date for the following taxable year. Using the charts above, the interest rate in effect for the entire interest accrual period is the rate for the period in which the interest accrual period begins.

Line 9 and Line 10 – Individuals and estates or trusts, sign Side 2 and file form FTB 3834 as a separate return (**do not** attach it to Form 540, Long Form 540NR, or Form 541). Mail form FTB 3834 in an envelope separate from that of your California tax return.

Corporations (other than S corporations) may deduct this amount as an interest expense for the taxable year in which it is paid or incurred. This interest is not deductible for individuals and other noncorporate taxpayers.

- **If you have a refund** (line 9), mail form FTB 3834 to:

  FRANCHISE TAX BOARD
  PO BOX 942840
  SACRAMENTO CA 94240-0002

- **If you have a tax due** (line 10), make a check or money order payable to "Franchise Tax Board" for the full amount. Write your social security number, individual taxpayer identification number, or California corporation number, the taxable year, and "FTB 3834" on the check or money order. Enclose, but **do not** staple, payment with form FTB 3834 and mail to:

  FRANCHISE TAX BOARD
  PO BOX 942867
  SACRAMENTO CA 94267-0001

Corporations, S corporations, partnerships, LLCs and exempt organizations with unrelated business income, attach form FTB 3834 to their California tax return and enter the amount due or the amount to be refunded on the appropriate schedule of their tax return as follows:

- Corporations, enter the amount due or the amount to be refunded on Form 100, Schedule J or Form 100W, Schedule J.
- S corporations, enter the amount due or the amount to be refunded on Form 100S, Schedule J.
- Exempt corporations or other organizations with unrelated business income, enter the amount due or the amount to be refunded on Form 109, Schedule K.
- Partnerships, enter the amount due or the amount to be refunded on Form 565, line 28 or line 30.
- LLCs, enter the amount due or the amount to be refunded on Form 568, line 10 or line 11.

Corporations, S corporations, exempt organizations, partnerships, and LLCs are not required to sign form FTB 3834.

Part II — Simplified Marginal Impact Method

Part II is used only by pass-through entities required to apply the look-back method at the entity level and taxpayers electing (or with an election in effect) to use the simplified marginal impact method. See General Information H, Simplified Marginal Impact Method.

To elect the simplified marginal impact method, attach a statement to form FTB 3834 for the first taxable year of the election. The statement must indicate that you are making an election under Treas. Reg. Section 1.460-6(d) to use the simplified marginal impact method. Once made, the election applies to all applications of the look-back method in the year of the election and all later years, unless the FTB consents to a revocation of the election.

Columns (a), (b), and (c) – Enter at the top of each column the ending month and year for each prior taxable year in which you were required to report income from the completed long-term contract.

Line 1 – In each column, show a net increase to income as a positive amount and a net decrease to income as a negative amount. For apportioning taxpayers, the net increase or net decrease to income is after apportionment. For more information, see Cal. Code Regs., tit. 18 section 25137-2.

Attach separate schedules for regular taxable income and AMTI that include the following:

- 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.
- The amount of income previously reported for each contract based on estimated contract price and costs for each prior year.
- The amount of income for each contract allocable to each prior year based on actual contract price and costs.
- The net adjustment to income from long-term contracts for each prior year.
- Any other adjustments that result in a change to income due to long-term contracts.

An owner of an interest in a pass-through entity is not required to provide the detail listed in the first three items above with respect to prior years. The entity should provide the line 1 amounts on Schedule K-1 (100S, 541, 565, or 568) or on a separate statement for its taxable year in which the contracts are completed or adjusted.

If you are reporting line 1 amounts from more than one Schedule K-1 (100S, 541, 565, or 568) or similar statement, you must attach a schedule detailing by entity, the net change to income from long-term contracts.

See Specific Line Instructions, **Line 2, Net Adjustment,** on page 2.

Line 2 – Multiply the amount on line 1 by the applicable regular tax rate for each prior year shown in column (a), (b), or (c). The applicable regular tax rate is as follows:

Entity	Regular rate
(a) Individuals and 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:	
Taxable years beginning before 1987	11%
Taxable years beginning after 1986 and before 1991	9.3%
Taxable years beginning after 1990 and before 1996	11%
Taxable years beginning after 1995	9.3%
Taxable years beginning after 2009	9.55%
(b) S corporations:	
Taxable years beginning after 1986 and before 1994	2.5%
Taxable years beginning after 1993	1.5%
(c) Corporations and pass-through entities not included in (a) or (b) above:	
Taxable years ending before 1987	9.6%
Taxable years ending after 1986 and beginning before 1997	9.3%
Taxable years beginning after 1996	8.84%

Corporations cannot reduce their tax below the minimum franchise tax.

Line 3 – See the instructions for Part II, line 1, and complete line 3 in the same manner, using only income and deductions allowed for AMT purposes.

Line 4 – Multiply the amount on line 3 by the applicable AMT rate as follows:

Entity	AMT rate
(a) Individuals and 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:	
Taxable years beginning after 1986 and before 1991	7%
Taxable years beginning after 1990 and before 1997	8.5%
Taxable years beginning after 1996 and before 2009	7%
Taxable years beginning after 2009	7.25%
(b) Corporations and pass-through entities not included in (a) above:	
Taxable years ending after 1986 and beginning before 1997	7%
Taxable years ending after 1996	6.65%

Line 5 – If both line 2 and line 4 are negative, enter whichever amount is **larger**. Treat both numbers as positive when making this comparison, but enter the amount as a negative number. If the amount on one line is negative, but the amount on the other line is positive, enter the positive amount on line 5.