Navigating the Accounting Method Change Landscape — The New §381 Regulations and Other Developments

by Dwight N. Mersereau, Esq.*

Navigating the accounting method change landscape can be difficult. Recently, a senior executive with the IRS Office of Chief Counsel conceded, with good reason, that the rules are Byzantine. The Treasury Department and the IRS frequently revise the rules without republishing them. As a result, a taxpayer seeking to follow the correct accounting method change process must reference as many as six different revenue procedures at once. Moreover, interpretations of the revenue procedures are often contained in obscure, non-precedential rulings. It is not surprising, then, that even practitioners specializing in tax accounting do not always completely understand the accounting method change process.

Nonetheless, because of frequent changes in the tax law and the financial accounting rules, unless taxpayers periodically change their methods of accounting, they will rarely find that all of their methods are both optimal and permissible. Therefore, taxpayers need to have a working knowledge of the accounting method change process. Fortunately, despite the complexity of the rules, they are based on sound tax policy, and as such, they can be deciphered. In the words of Polonius, “Though this be madness, yet there is method in’t.”

This article discusses the various circumstances under which a taxpayer or the Commissioner is permitted to change a taxpayer’s method of accounting and the procedures they must follow when doing so.

BACKGROUND

Methods of accounting determine when a taxpayer takes into account an item of income or deduction. A simple example is a taxpayer that performs services in 2010 but does not receive payment for performing those services until 2011. The year in which the taxpayer must include the payment in its gross income depends on which method of accounting the taxpayer uses. If it is using an accrual method, the taxpayer will include the payment for performing the services in gross income for the taxable year in which all events occur that establish its right to receive the income.
come, provided it can determine the amount thereof with reasonable accuracy.\(^6\) By contrast, if it is using the cash receipts and disbursements method, the taxpayer will include the payment for performing the services in gross income for the taxable year in which it actually or constructively receives it.\(^7\)

A taxpayer may adopt any permissible overall method of accounting (either the cash receipts and disbursements method or an accrual method) in its first federal income tax return, and may adopt any permissible special method of accounting\(^8\) for an item within that overall method in the first federal income tax return it files that accounts for the item.\(^9\) For example, a calendar year taxpayer that receives its first advance payment in 2011 may adopt any permissible method of accounting for advance payments in its 2011 federal income tax return. A taxpayer adopts an impermissible method of accounting by using the impermissible method on two consecutively filed federal income tax returns.\(^10\)

After adopting a method of accounting (including an overall method or a special method for an item within the overall method), a taxpayer must consistently use the method for all items arising during the year, and from year to year.\(^11\) For example, if a taxpayer adopts a deferral method of accounting for advance payments, it must use that deferral method to account for all advance payments that it receives, both during the year and in all subsequent years.

A taxpayer generally may not change from a method of accounting without first obtaining the consent of the Commissioner of Internal Revenue, regardless of whether the method is permissible or impermissible.\(^12\) Although a taxpayer may not change from an impermissible method without first obtaining the consent of the Commissioner, a taxpayer that continues to use an impermissible method of accounting is nonetheless subject to any otherwise applicable penalty.\(^8\) The IRS, however, will not impose such penalties on a taxpayer that voluntarily changes to a permissible method in accordance with Regs. §1.446-1(e)(3).\(^14\)

What constitutes a change in method of accounting is often unclear, and consequently, is the subject of frequent controversy.\(^15\) For example, a taxpayer may correct an error in its application of a method, and doing so does not constitute a change in method of accounting.\(^16\) Nonetheless, it is not always clear what constitutes an error in the application of a method.\(^17\)

For example, if a taxpayer has an established method of accounting for contract losses on fuel, which is to recognize the loss in the year incurred, and the taxpayer does not recognize contract losses on nuclear fuel in the year incurred, the taxpayer can correct its error by amending its return to account for contract losses on nuclear fuel consistent with its established method of accounting.\(^18\) On the other hand, if a taxpayer has an established method of accounting for original issue discount (OID), which is to amortize OID into income over the life of the loan, and the taxpayer does not amortize OID from late fees into income over the life of the loan, the taxpayer cannot correct its error by amending its return to account for OID from late fees consistent with its established method of accounting. Instead, the taxpayer was treated as having a separate method of accounting for OID from late fees.\(^19\)

A taxpayer that uses a new method of accounting on two consecutively filed federal income tax returns without following the appropriate procedures has made an “unauthorized” change in method of accounting in violation of §446(e).\(^20\) In such cases, the Commissioner may change the taxpayer back to its prior method of accounting.\(^21\) The Commissioner, however, may be reluctant to do so if the prior method was impermissible.\(^22\) Moreover, the Commissioner might be unable to change the taxpayer from the new

\(^{6}\) Regs. §1.446-1(c)(1)(ii)(A).
\(^{7}\) Regs. §1.446-1(c)(1)(i).
\(^{9}\) Regs. §1.446-1(e)(1).
\(^{10}\) Rev. Rul. 90-38, 1990-1 C.B. 57.
\(^{11}\) Regs. §1.446-1(a)(2).
\(^{12}\) §446(e); Regs. §1.446-1(e)(2)(i); Rev. Rul. 90-38.
\(^{13}\) §446(f).
\(^{15}\) For example, two circuit courts recently have addressed the issue: Bosamia v. Comr., 108 AFTR2d 2011-6901 (5th Cir. 2011), and Capital One Financial Corp. v. Comr., 108 AFTR2d 2011-6875 (4th Cir. 2011).
\(^{16}\) Regs. §1.446-1(e)(2)(ii)(b).
\(^{17}\) For rules regarding what is (and what is not) a change in method of accounting with respect to amortization and depreciation, see Regs. §1.446-1(e)(2)(ii)(d).
\(^{18}\) Northern States Power Co. v. U.S., 151 F.3d 876 (8th Cir. 1998).
\(^{19}\) Capital One Financial Corp., above at n. 15.
\(^{20}\) Rev. Rul. 90-38.
\(^{22}\) See FSA 200102004 (Commissioner should not change the taxpayer from a permissible method back to an impermissible method solely because the taxpayer changed its method without
method of accounting if the taxpayer changed to an otherwise permissible method of accounting and the taxpayer made the unauthorized change in a year that is closed under the statute of limitations.\footnote{23 See Comr. v. Brookshire Brothers, 320 F.3d 507 (5th Cir. 2003). The IRS does not agree with this conclusion. §2.06 of Rev. Proc. 2002-18, 2002-1 C.B. 678.}

In addition to a taxpayer voluntarily changing its method of accounting, the Commissioner may involuntarily change a taxpayer’s method of accounting on audit, but only if the taxpayer’s method does not clearly reflect the taxpayer’s income.\footnote{24 §446(b).} The Commissioner, for example, cannot change a taxpayer from one permissible method to another permissible method that, in the opinion of the Commissioner, “more clearly reflects” the taxpayer’s income.\footnote{25 Molsen v. Comr., 85 T.C. 485, 498 (1985); §2.02(5) of Rev. Proc. 2002-18.}

**AUTHORIZED ACCOUNTING METHOD CHANGES**

An authorized accounting method change generally falls into one of four categories: (1) an advance consent change; (2) an “automatic consent” change; (3) an involuntary change; and (4) a change in a §381(a) transaction.\footnote{26 Other techniques for changing a method of accounting might be available. For example, if a taxpayer transfers property to a newly formed corporation in a transfer pursuant to §351, the transferee generally may adopt its own methods of accounting, effectively permitting the transferee to change the method of accounting. Various rules, however, might apply to prevent such techniques. For example, a transferee may not always be able to adopt a method of accounting different from the method used by the transferor when the transferee and transferor are members of an affiliated group filing a consolidated return. See Regs. §1.1502-17(c). Because such techniques are outside the accounting method change procedures, they are outside the scope of this article.}

Each category is discussed in detail below.

**AN ADVANCE CONSENT CHANGE**

A taxpayer that wants to obtain the consent of the Commissioner to change its method of accounting generally must do so by filing a Form 3115, *Application for Change in Accounting Method* (“application”),\footnote{27 See TAM 201030025 (taxpayer’s consent to change its method of accounting revoked, even though the taxpayer did not misstate the facts in the application, because the Commissioner issued the ruling in error, which became evident when the nature of the costs subject to the change became clear on audit); Capital One Financial Corporation, above, at n. 15 (the burden is on the taxpayer to make both its intentions and its requests clear in the Form 3115).} under the advance consent procedure, Rev. Proc. 97-27,\footnote{28 1997-1 C.B. 680, as amplified and modified by Rev. Proc. 2002-19, 2002-1 C.B. 696, as amplified and clarified by Rev. Proc. 2002-54, 2002-2 C.B. 432, as modified by Rev. Proc. 2007-67, 2007-2 C.B. 1072, as clarified and modified by Rev. Proc. 2009-39, and as clarified and modified by Rev. Proc. 2011-14, 2011-4 I.R.B. 330. All references in this article to the advance consent procedure and all citations to Rev. Proc. 97-27 are to Rev. Proc. 97-27 as amplified, clarified, and modified by those revenue procedures.} and the private letter ruling procedure, Rev. Proc. 2011-1.\footnote{29 These procedures are outside the scope of this article.}

**Practice Tip:** Because a request for the Commissioner’s consent to change a method of accounting is a private letter ruling request, a taxpayer must disclose all material facts, regardless of whether the application requests the information.\footnote{30 Regs. §1.446-1(e)(3); §9.01(2) of Rev. Proc. 2011-1. There is a user fee for filing the application (currently, the fee is $4,200, but there are additional fees and reduced fees in certain circumstances). §15 and Appendix A of Rev. Proc. 2011-1. Unlike most private letter rulings, the IRS does not publish accounting method change rulings. §6110(g)(5)(B)(iii).} Moreover, the greater the information the taxpayer provides to the Commissioner in the application, the greater the certainty the taxpayer will have that the Commissioner will not later revoke the ruling because of undisclosed information the IRS discovers on audit.\footnote{31 See TAM 201030025 (taxpayer’s consent to change its method of accounting revoked, even though the taxpayer did not misstate the facts in the application, because the Commissioner issued the ruling in error, which became evident when the nature of the costs subject to the change became clear on audit); Capital One Financial Corporation, above, at n. 15 (the burden is on the taxpayer to make both its intentions and its requests clear in the Form 3115).}

**Practice Tip:** The advance consent procedure has been revised numerous times since its original publication. Until the IRS republishes the advance consent procedure with all of the changes incorporated, taxpayers should ensure that they have a copy of it marked up with all of the changes made by the following revenue procedures (and any others that are released subsequently):

- Rev. Proc. 2002-19,
- Rev. Proc. 2002-54,
- Rev. Proc. 2007-67,
- Rev. Proc. 2009-39, and
- Rev. Proc. 97-27, as amplified and clarified, and modified by those revenue procedures.
The deadline for filing the application generally is the last day of the taxable year for which the taxpayer wants to implement the change.33

Practice Tip: As discussed below, a taxpayer generally is not permitted to file an application after it has been contacted by an IRS examination agent for purposes of scheduling an examination. Therefore, the deadline for filing the application is actually the day before the taxpayer is contacted by the examining agent, which is unknown. As a result, a taxpayer that is not currently under examination should consider filing the application as soon as possible after it decides to change its method of accounting.

The Commissioner has limited discretion in determining whether to grant consent to a taxpayer seeking to change from an impermissible method,34 but he has wider discretion in determining whether to grant consent to a taxpayer seeking to change from a permissible method because consistency is a factor in determining whether a taxpayer’s method clearly reflects its income.35 For example, the Commissioner generally does not grant consent to a taxpayer that, within the last five taxable years, adopted or changed to the method of accounting that it is seeking consent to change.36 Of course, because of the Commissioner’s limited discretion when a taxpayer is using an impermissible method, the Commissioner almost certainly will grant his consent in such situations.

The Commissioner has the authority to impose terms and conditions for granting his consent.37 The terms and conditions that the Commissioner generally requires are published in the advance consent procedure.38 The Commissioner, however, may alter the published terms and conditions in a particular case, “in the interests of sound tax administration.”39

One of the terms and conditions the Commissioner imposes is the year of change. Although the Commissioner has the authority to grant consent to a taxpayer to make a retroactive change,40 the Commissioner generally will not do so.41 Consequently, the change generally is effective as of the first day of the taxable year in which the taxpayer timely files the application.42

Practice Tip: Under certain circumstances, the Commissioner will allow a taxpayer to move the year of change to a later year, if the application is still pending with the IRS National Office in the later year.43 A taxpayer may want to make this request if the application is still pending when the taxpayer files its federal income tax return for the original year of change because it generally is not permitted to implement the change until after it receives the consent of the Commissioner.44 Therefore, if the taxpayer files the return on its present method of accounting, does not move the year of change forward, and later receives the consent of the Commissioner to make the change, the taxpayer must amend its federal income tax return (and one or more state income tax returns) for the year of change to properly implement the change in method of accounting.

Alternatively, if the application is still pending when the taxpayer files its federal income tax return for the original year of change, the taxpayer may want to consider45 filing the return using the proposed method of accounting because, even though it has not yet received the consent of the Commissioner to change its method, it nevertheless may rely on the consent of the Commissioner if it later receives it.46 However, if the taxpayer’s application is later denied, modified, withdrawn, or the taxpayer does not otherwise receive the consent of the Commissioner to change to the proposed method, the taxpayer should amend any returns it filed on the proposed method (including any affected state returns), and it is subject to interest, penalties, and other adjust-

32 The IRS and Treasury have no current plans to republish the advance consent procedure. For members of the AICPA Tax Section, a marked-up copy of the advance consent procedure is available on the section’s website.
33 Regs. §1.446-1(e)(3)(i); §5.01 of Rev. Proc. 97-27.
35 See Regs. §1.446-1(c)(2)(ii). See also §2.07 of Rev. Proc. 97-27.
36 §8.05(1) of Rev. Proc. 97-27.
37 Regs. §1.446-1(e)(3)(i) and (ii).
38 See §5.02 of Rev. Proc. 97-27.
42 §5.02(2) of Rev. Proc. 97-27.
45 Any professional, ethical, or other similar considerations associated with a taxpayer filing a federal income tax return using the proposed method of accounting before it receives the consent of the Commissioner to change to the new method of accounting are beyond the scope of this article.
ments resulting from making an unauthorized change in method of accounting.\textsuperscript{47}

In addition to setting the year of change, the Commissioner usually will require the taxpayer to take into account an adjustment to prevent the duplication or omission of an item of income or deduction that would otherwise result solely as a result of the change in method of accounting.\textsuperscript{48}

For example, a taxpayer that seeks to change from the cash receipts and disbursements method to an accrual method would not have included in income in the years prior to the year of change amounts that it did not actually or constructively receive in those years. Furthermore, the taxpayer will not include in the year of change (or any subsequent year) amounts that it receives that properly would have been accrued under its new method in the prior years. Thus, without an adjustment, the taxpayer would omit entirely such payments from income.

Therefore, except as noted below, the Commissioner will condition the granting of his consent on the taxpayer agreeing to include in gross income the amount that would otherwise be omitted solely as a result of the change. The Commissioner will impose a similar condition with respect to items of expense that would be duplicated or omitted solely as a result of the change in method of accounting.

However, the Commissioner may permit taxpayers to make certain changes without taking into account a §481(a) adjustment, a so-called “cut-off change.”\textsuperscript{49} Under a cut-off change, the taxpayer is permitted to use the proposed method only with respect to items arising after the beginning of the year of change such that no duplication or omission will occur, and therefore, no §481(a) adjustment is necessary.\textsuperscript{50}

Generally, the Commissioner will require the taxpayer to spread an unfavorable §481(a) adjustment ratably over four taxable years, beginning with the year of change.\textsuperscript{51} The adjustment period is reduced under certain, limited circumstances.\textsuperscript{52} If the change results in an adjustment that reduces the taxpayer’s income, however, the taxpayer must include the adjustment entirely in the year of change.\textsuperscript{53}

\textit{Practice Tip:} Even though taxpayers are not required to pay interest on the deferral of the §481(a) adjustment, in some cases a taxpayer may not want to spread the adjustment over four years (for example, if the taxpayer had an expiring net operating loss). In the author’s experience, however, the Commissioner will not provide a shorter spread period. Furthermore, a Treasury Official recently stated that a taxpayer that uses a spread period that is contrary to the terms and conditions granted to the taxpayer is making an unauthorized change in method of accounting, and that the IRS could, therefore, revoke the taxpayer’s consent.\textsuperscript{54} It is arguable that the Commissioner would abuse his discretion if he withheld his consent for a taxpayer to change from an impermissible method unless the taxpayer agreed to spread the §481(a) adjustment.\textsuperscript{55}

The terms and conditions that the Commissioner offers to taxpayers that voluntarily change their methods of accounting are more favorable than the terms and conditions that the Commissioner imposes on taxpayers that are required to change their methods of accounting as a result of an IRS examination.\textsuperscript{56} For example, in addition to the four-year spread of an unfavorable §481(a) adjustment, if a taxpayer voluntarily changes its method of accounting in accordance with the advance consent procedure, the IRS will not require the taxpayer to change its method of accounting for the same item for a taxable year prior to the taxpayer’s requested year of change, so-called “audit protection.”\textsuperscript{57} The Commissioner offers these more favorable terms and conditions to a taxpayer that voluntarily changes its method of accounting to provide an incentive to taxpayers that are using impermissible methods of accounting to voluntarily change to permissible methods.\textsuperscript{58}

\textbf{Taxpayers Under IRS Examination}

Because of the desire to encourage taxpayers to voluntarily change from impermissible methods of ac-

\begin{itemize}
\item \textsuperscript{47} Id.
\item \textsuperscript{48} §481(a). See also Regs. §1.446-1(e)(3)(i) and §2.05 of Rev. Proc. 97-27.
\item \textsuperscript{49} Regs. §1.446-1(e)(3)(ii) and §2.06 of Rev. Proc. 97-27.
\item \textsuperscript{50} §2.06 of Rev. Proc. 97-27. See also Regs. §1.381(c)(4)-1(b)(17).
\item \textsuperscript{51} §5.02(3) of Rev. Proc. 97-27.
\item \textsuperscript{52} §7.03 of Rev. Proc. 97-27.
\item \textsuperscript{53} §5.02(3) of Rev. Proc. 97-27.
\end{itemize}
counting, the advance consent procedure generally does not apply to a taxpayer that is under examination by the IRS,\(^\text{59}\) including a taxpayer that has a refund or credit under review by the Joint Committee on Taxation.\(^\text{60}\) If the Commissioner permitted taxpayers that are under examination to change their methods of accounting under the terms and conditions of the advance consent procedure, taxpayers, to get the latest possible year of change, might wait until after they are contacted for examination to apply to change their methods of accounting.

A taxpayer that is not otherwise under examination that joins a consolidated group that is under examination for years before the taxpayer joined the consolidated group is not “under examination” by virtue of joining the consolidated group.\(^\text{61}\) However, a taxpayer that joins a consolidated group that is in the Compliance Assurance Process (CAP) program likely will be under examination because a taxpayer in the CAP program generally is under examination for its current taxable year, which is the year the taxpayer joins the consolidated group.\(^\text{62}\) On the other hand, if a taxpayer is a member of a consolidated group that is under an IRS examination for years that the taxpayer was a member of the group, the taxpayer will remain “under examination” even if it leaves the consolidated group.\(^\text{63}\)

An examination generally begins when a taxpayer has been “contacted in any manner by a representative of the Service for the purpose of scheduling any type of examination of the return.”\(^\text{64}\) Whether a taxpayer is “under examination,” and therefore, ineligible to voluntarily change its method of accounting, has been an issue of controversy. For example, in TAM 9806004, the IRS National Office concluded that a taxpayer was under examination when it was contacted by an examining agent and informed that it was selected for examination. The memorandum stated that such contact was “the first step in scheduling an examination.”

Because some taxpayers are under continuous audit, however, the advance consent procedure provides exceptions to accommodate these taxpayers.\(^\text{65}\) The first exception applies to a taxpayer that has been under and IRS examination for 12 consecutive months as of the first day of a taxable year. Under the exception, such a taxpayer may voluntarily file to change its method of accounting during the first 90 days of the qualifying taxable year, during the so-called “90-day window.”\(^\text{66}\) The rationale for the exception is that voluntary compliance will not be compromised if a taxpayer under examination can voluntarily change its methods of accounting only after the Commissioner first has had at least 12 months to audit and raise accounting method issues.

The 90-day window exception does not apply, however, if the method of accounting the taxpayer wants to change is an issue under consideration or the examining agent has placed the issue in suspense.\(^\text{57}\) An issue is “under consideration” “if the taxpayer receives written notification from the examining agent specifically citing the treatment of the item as an issue under consideration.”\(^\text{68}\) The question of when an item is an issue under consideration within the meaning of the advance consent procedure has been the subject of controversy. For example, in TAM 200843031, the IRS National Office concluded that the taxpayer’s capitalization method of accounting for royalties was an issue under consideration because the examining agent requested, through an information document request, the taxpayer’s work papers for its inventory costs, which would reasonably have been expected to contain the taxpayer’s computations related to the capitalization of its royalties.

A second exception permits a taxpayer that is under examination to voluntarily file to change its method of accounting during the first 120 days after an IRS examination ends, even if another IRS examination has begun, during the so-called “120-day window.”\(^\text{69}\) The 120-day window ends, however, if an Appeals officer refers the case back to examination for reconsideration.\(^\text{70}\) The rationale for the 120-day window, similar to the rationale for the 90-day window, is that voluntary compliance will not be compromised if a taxpayer is permitted to voluntarily change its method of accounting only after the IRS has had an entire audit to raise accounting method issues. This exception does not apply if the method of accounting the taxpayer wants to change is an issue under consideration.

---

\(^{59}\) \S 4.02(2) of Rev. Proc. 97-27.

\(^{60}\) \S 3.07(3) of Rev. Proc. 97-27.

\(^{61}\) \S 4.02(5) of Rev. Proc. 97-27.


\(^{63}\) \S 4.02(2) of Rev. Proc. 97-27.

\(^{64}\) \S 3.07(3) of Rev. Proc. 97-27.

\(^{65}\) In the late 1960s, the IRS began the Coordinated Industry Case (CIC) Program (known at the time as the Coordinated Ex-

---
or an issue that the examining agent has placed in suspense.\footnote{\sref{6.01(3)(a)}{Rev. Proc. 97-27.}}

A third exception permits a taxpayer that is under examination to voluntarily file to change its method of accounting if it obtains the consent of the director.\footnote{\sref{6.01(4)(a)}{Rev. Proc. 97-27.}} The advance consent procedure provides that the director “will” consent to the filing, “unless, in the opinion of the director, the method of accounting to be changed would ordinarily be included as an item of adjustment in the year(s) for which the taxpayer is under examination.”\footnote{\sref{6.01(4)(a)}{Rev. Proc. 97-27.}} The rationale for the director consent exception is that voluntary compliance will not be compromised if a taxpayer is permitted to voluntarily change a method of accounting that the IRS will not change on audit. Examples of such changes are a change from a clearly permissible method of accounting and a change from an impermissible method that the taxpayer adopted subsequent to the years under examination.\footnote{\sref{6.01(3)(a)}{Rev. Proc. 97-27.}} It is significant that the examining agent is not consenting to the change itself, only to the taxpayer filing the application with the IRS National Office, which retains jurisdiction over the consent to the change. Taxpayers sometimes must stress this point with examining agents that are reluctant to grant consent without scrutinizing and agreeing with the proposed method.

A fourth exception permits a taxpayer that is under examination to file to change its method of accounting if the method it seeks to change is an issue pending on examination.\footnote{\sref{6.01(4)(a)}{Rev. Proc. 97-27.}} An issue is pending if the examining agent “has given the taxpayer written notification indicating an adjustment is being made or will be proposed with respect to the taxpayer’s method of accounting.”\footnote{\sref{6.01(4)(a)}{Rev. Proc. 97-27.}} The audit protection that ordinarily applies to a voluntary change does not apply to a change filed under this exception.\footnote{\sref{6.01(4)(a)}{Rev. Proc. 97-27.}}

The rationale for this exception is that voluntary compliance is not compromised by permitting the taxpayer to make a voluntary change because the examining agent already has proposed adjustments with respect to the method the taxpayer is changing. This exception was necessary to address the situation of a taxpayer that is under continuous examination that is using an impermissible method of accounting that the IRS adjusts on examination. Because of the IRS’s adjustments to the taxpayer’s method of accounting in each examination, the taxpayer will not qualify for the other exceptions; that is, the taxpayer would not be eligible for the 90- or 120-day windows because the taxpayers method would be an issue under consideration, and it would not be able to obtain the consent of the director because “the method of accounting to be changed would ordinarily be included as an item of adjustment in the year(s) for which the taxpayer is under examination.”\footnote{\sref{6.01(4)(a)}{Rev. Proc. 97-27.}} Therefore, the taxpayer would not be able to change to another method of its choosing while it remains under continuous examination. For example, a taxpayer using an impermissible last-in, first-out (LIFO) inventory method of accounting would not be able to change to a simplified LIFO method if an examining agent makes adjustments the taxpayer’s present LIFO method in each audit cycle. Under the exception, however, the examining agent would be able to make adjustments to the taxpayer’s present LIFO method for the years under examination, and the taxpayer would be able to change to another LIFO method for the current and future years.

\section*{Taxpayers Before an Appeals Officer or Before a Federal Court}

A taxpayer that is otherwise within the scope of the advance consent procedure, and is before an IRS Appeals office or a federal court, may file an application under the advance consent procedure.\footnote{\sref{6.02 and 6.03}{Rev. Proc. 97-27.}} Furthermore, a taxpayer not otherwise permitted to file an application under the advance consent procedure because it is under examination, and is also before an IRS Appeals office or a federal court, may file an application under the advance consent procedure if the method to be changed is an issue under consideration by the IRS Appeals office or the federal court.\footnote{\sref{6.02 and 6.03}{Rev. Proc. 97-27.}} However, the audit protection provisions do not apply if the method to be changed is an issue under consideration by the IRS Appeals office or the federal court.\footnote{\sref{6.02 and 6.03}{Rev. Proc. 97-27.}} The rationale for this exception is that voluntary compliance will not be compromised since the IRS already has raised the issue and the taxpayer is not afforded audit protection.

\section*{Implementing the Change}

If the Commissioner contemplates not granting his consent to the taxpayer to make the change, the Com-
missioner will notify the taxpayer before making a final decision.\textsuperscript{81} If the taxpayer requested it on the application,\textsuperscript{82} the Commissioner will offer the taxpayer “a conference of right” in which to persuade the Commissioner to grant consent.\textsuperscript{83}

\textit{Practice Tip:} A taxpayer should always request a conference of right when submitting the application; a taxpayer can always decline the offer of the conference if the Commissioner is adverse to the application, but the Commissioner is not required to offer the conference if the taxpayer does not request it.

\textit{Practice Tip:} If the taxpayer is not able to persuade the Commissioner to grant consent to its requested method of accounting, the taxpayer should consider discussing at the conference modifications to its proposed method of accounting (or alternative methods of accounting) that might be acceptable to the Commissioner.\textsuperscript{84}

If the Commissioner grants consent to the taxpayer to make a change, the Commissioner will mail the taxpayer a Consent Agreement, which outlines the facts, the present and proposed methods of accounting, and the terms and conditions under which the Commissioner has granted consent, including the amount of the §481(a) adjustment, if any.\textsuperscript{85} The Consent Agreement is the taxpayer’s letter ruling, and the taxpayer has 45 days in which to sign and return the Consent Agreement to the IRS National Office.\textsuperscript{86} Even though the Consent Agreement contains the amount of the §481(a) adjustment, the taxpayer does not have “ruling protection” on the amount of the §481(a) adjustment. Therefore, an IRS examining agent may re-determine the amount of the §481(a) without revoking the Consent Agreement.\textsuperscript{87}

\textit{Practice Tip:} The taxpayer should always carefully read the Consent Agreement to ensure that the recitation of the facts is accurate and complete, that the present and proposed methods are properly described, and that the amount of the §481(a) adjustment is correct.

To receive the terms and conditions granted under the Consent Agreement, including the audit protection, the year of change, and the spread of the §481(a) adjustment, the taxpayer must not only sign and return the Consent Agreement within the 45-day period, it must also properly implement the change in method of accounting in accordance with all the applicable provisions of the advance consent procedure and the terms and conditions provided in the Consent Agreement.\textsuperscript{88} If the taxpayer disagrees with the terms and conditions provided in the Consent Agreement, or the Consent Agreement does not accurately recite the facts or does not properly describe the present or proposed method, the taxpayer must notify the designated contact person in the IRS National Office within the 45-day period.\textsuperscript{89} If the Commissioner agrees with the taxpayer, he will modify the Consent Agreement and reissue it to the taxpayer. Otherwise, the taxpayer will have 15 days to sign and return the original Consent Agreement if it wants to implement the change under the original terms and conditions.\textsuperscript{90}

\textit{Practice Tip:} If the taxpayer rejects the change and in the next four taxable years wants to change the same item, the Commissioner will take into consideration the fact that the taxpayer applied for, but did not make, the change in method of accounting.\textsuperscript{91}

\textbf{Effect of Consent}

The Commissioner may require a taxpayer that receives consent to change its method of accounting to change or modify the new method of accounting for the following reasons:

- The enactment of legislation;
- A decision of the United States Supreme Court;
- The issuance of final or temporary regulations;
- The issuance of a revenue ruling, revenue procedure, notice or other statement published in the Internal Revenue Bulletin; or
- A change in the material facts on which the consent was based.\textsuperscript{92}

Although not explicitly stated in the advance consent procedure, it is likely that the Commissioner could require the taxpayer to change its method of accounting only if one of the above described events ac-

\begin{itemize}
\item \textsuperscript{81} §10.03 of Rev. Proc. 2011-1 and §8.10 of Rev. Proc. 97-27.
\item \textsuperscript{82} Such a request is made by checking box 16 on the Form 3115.
\item \textsuperscript{83} §8.10 of Rev. Proc. 97-27. For the procedures for holding the conference of right, refer to §10 of Rev. Proc. 2011-1.
\item \textsuperscript{84} See §9.10 of Rev. Proc. 2011-1.
\item \textsuperscript{85} §8.11 of Rev. Proc. 97-27.
\item \textsuperscript{86} Id.
\item \textsuperscript{87} §§11.01(2) and 11.02 of Rev. Proc. 97-27.
\item \textsuperscript{88} §§8.03 and 8.11 of Rev. Proc. 97-27.
\item \textsuperscript{89} §8.11(4)(b) of Rev. Proc. 97-27.
\item \textsuperscript{90} Id.
\item \textsuperscript{91} §§8.05(1)(b) of Rev. Proc. 97-27.
\item \textsuperscript{92} §10.01 of Rev. Proc. 97-27.
\end{itemize}
If the Commissioner requires a taxpayer that received consent to change its method of accounting to change or modify the new method of accounting, except in rare or unusual circumstances, the Commissioner will not require the taxpayer to change or modify its method retroactively, provided that:

- The taxpayer complied with all the applicable provisions of the Consent Agreement and Rev. Proc. 97-27;
- The taxpayer did not omit or misrepresent a material fact;
- There has been no change in the material facts on which the consent was based;
- There has been no change in the applicable law; and
- The taxpayer acted in good faith in relying on the consent and applying the change or modification retroactively would be to the taxpayer’s detriment.  

**AN “AUTOMATIC CONSENT” CHANGE**

A taxpayer must file its application to change its method of accounting under Rev. Proc. 2011-14, the automatic consent procedure, instead of the advance consent procedure, if the method of accounting the taxpayer wants to change is described in the Appendix of the automatic consent procedure. One of the most significant differences between the two procedures is that the Commissioner will not issue a Consent Agreement to a taxpayer filing its application under the automatic consent procedure. Instead, if the taxpayer follows all of the applicable provisions in the automatic consent procedure and properly implements the change on its federal income tax return for the requested year of change, the taxpayer is deemed to have the consent of the Commissioner to make the accounting method change.

**Practice Tip:** Although using the automatic consent procedure is not optional, there are some disadvantages to using it. One of the principal disadvantages is the degree of uncertainty regarding whether the taxpayer has

---

93 See §446(b).
94 §10.02 of Rev. Proc. 97-27. See TAM 201030025 (taxpayer’s consent to change its method of accounting was revoked prospectively because, although issued in error, the taxpayer relied on the ruling in good faith and did not omit or misstate any material facts).
95 §11.01 of Rev. Proc. 97-27.
96 Id.
97 §11.02 of Rev. Proc. 97-27. The technical advice procedures are contained in Rev. Proc. 2011-2, 2011-1 I.R.B. 90, and generally permit the taxpayer to participate in the process. In the author’s experience, controversy sometimes develops over whether the examining agent is modifying or revoking the ruling, requiring the examining agent to seek technical advice from the IRS National Office, or is simply requiring the taxpayer to properly implement the ruling, in which case the examining agent is not required to seek technical advice.
100 §6.01 and 6.06 of Rev. Proc. 2011-14. Thus, the procedure is referred to as the “automatic consent procedure,” and changes made under it are referred to as “automatic changes.”
in fact received the consent of the Commissioner to make the change. While in some cases a taxpayer may have little doubt that it has complied with all the applicable provisions of the automatic consent procedure, in other cases a taxpayer may be uncertain. For example, the taxpayer may be uncertain about whether it is within the scope of the revenue procedure or whether its proposed method is described in the Appendix. Although a taxpayer also may have some uncertainty with regard to an application filed under the advance consent procedure (for example, whether the taxpayer properly implemented the change), the degree of uncertainty is greater when a taxpayer files its application under the automatic consent procedure.

With careful planning, a taxpayer seeking greater certainty than that provided under the automatic consent procedure may file its application under the advance consent procedure. For example, to use the automatic consent procedure, a taxpayer’s proposed method must be described in its Appendix. Therefore, if a taxpayer’s proposed method varies from the method described in the Appendix, the taxpayer may file its application under the advance consent procedure. Although the Commissioner might reject the taxpayer’s application on the basis that the taxpayer’s proposed method is described in the Appendix (or require the taxpayer to modify its proposed method so that it does conform to the method described in the Appendix), and although such a rejection might not be a ruling that the taxpayer qualifies to use the automatic consent procedure, such a rejection is strong evidence that the taxpayer is so qualified. Thus, whether its application is rejected or not, the taxpayer will have greater certainty that it has received the consent of the Commissioner to make the change.

Although the automatic consent procedure generally has the scope limitations that are contained in the administrative guidance apply. The first additional scope limitation is that a taxpayer generally may not use the automatic consent procedure if it has engaged in a transaction to which §381(a) applies within the proposed taxable year of change. The original rationale for this limitation was that, because the regulations under §381 might require the taxpayer to make a change in method of accounting, the taxpayer should not be permitted to circumvent those rules by making a change under the automatic consent procedure. As discussed in detail below, the regulations under §381, upon which this limitation was based, were changed effective as of August 31, 2011. The new §381 regulations specifically permit a taxpayer to request the consent of the Commissioner to change the taxpayer’s method of accounting during the year in which it engages in a transaction to which §381(a) applies. Therefore, the original rationale for this limitation might not be valid any longer, but the regulations provide that, unless specifically waived, any scope limitations in the administrative guidance apply.

A Treasury official recently stated that not waiving this particular scope limitation was “an oversight” and that the IRS and Treasury likely would correct this oversight when they next revise the automatic change procedure. Regardless of whether the omission of the waiver was an oversight, the IRS appears satisfied with the current scope limitation. An IRS official recently stated that the IRS wants taxpayers that have engaged in a transaction to which §381(a) applies during the proposed taxable year of change to file applications to change their methods of accounting under the advance consent procedure rather than the automatic consent procedure so that the IRS National Office can monitor such applications, at least until the IRS National Office has “a better sense of what’s out there and what type of changes taxpayers

---

101 The author understands that the IRS National Office will not provide a taxpayer a ruling with regard to whether the taxpayer is within the scope of Rev. Proc. 2011-14 or whether its proposed method is described in the Appendix.
are requesting." Therefore, for the present, taxpayers that engage in transactions to which §381(a) applies during the proposed taxable year of change will need to file applications to change their methods of accounting under the advance consent procedure, unless the scope limitation is waived for the particular change the taxpayer wants to make.  

The second additional limitation prohibits a taxpayer from using the automatic consent procedure if in the year of change the taxpayer ceases to engage in the trade or business to which the change relates or terminates its existence.  

The rational for this limitation is that a method of accounting that generally would clearly reflect the income of a continuing enterprise might not clearly reflect the income of an enterprise that ceases its existence. Therefore, the Commissioner will not grant automatic consent so that he may review the application to ensure the taxpayer’s proposed method clearly reflects its income.

The third and fourth additional limitations generally prohibit a taxpayer from using the automatic consent procedure to change an overall method or a method of accounting for a specific item, respectively, if the taxpayer changed, or applied to change, the same method of accounting within the five previous taxable years, regardless of whether the taxpayer ultimately made the change. The rationale for the limitation is that, to clearly reflect income, a taxpayer generally must use a method of accounting consistently. Exceptions to this scope limitation are provided in transition rules, for changes that are required by another change, and for sub-methods within the LIFO inventory method.

Practice Tip: Although the above scope limitations are not contained in the advance consent procedure, it is fair to assume that generally the reason the Commissioner did not permit taxpayers to make the change under the automatic consent procedure is that he generally would not approve such a change under the advance consent procedure unless there are unusual and compelling circumstances. Therefore, if it cannot apply for a change in method of accounting under the automatic consent procedure solely as a result of one of the above-described additional scope limitations, the taxpayer should explain in the application the unusual and compelling circumstances under which the Commissioner should grant that change under the advance consent procedure.

A taxpayer using the automatic consent procedure generally obtains the same terms and conditions that it would obtain under the advance consent procedure, such as a four-year spread of the §481(a) adjustment.

Practice Tip: While the operative provisions of the automatic consent procedure contain the general rules and the terms and conditions for accounting method changes made under the procedure, the Appendix often modifies or waives the general rules and the terms and conditions for particular changes. For example, the scope limitations provided in §§4.02(4) and (5) (limitations with respect to §381(a) transactions and the final year of a trade or business) are waived in §6.01(2) of the Appendix, applicable to taxpayers changing from impermissible depreciation methods. Therefore, a taxpayer should always carefully review the applicable section in the Appendix to determine the rules and the terms and conditions that apply to the particular change it is making.

Taxpayers using the automatic consent procedure must file the application in duplicate; the taxpayer must file the original application with its timely filed federal income tax return for the year of change, and file a copy of the application with the IRS National Office. The taxpayer may file the copy with the IRS National Office beginning on the first day of the year of change and no later than when the taxpayer files the original application with its federal income tax return.

Practice Tip: The extended filing deadline is one of the principle advantages to using the automatic consent procedure. If, while preparing its federal income tax return, a taxpayer notices that it is not using an optimal method of accounting for a method described in the

---

107 Scott Dinwiddie, Special Counsel to the Associate Chief Counsel (Income Tax & Accounting), Remarks at the American Bar Association Tax Section fall meeting (Oct. 21, 2011), as reported in Tax Notes Today, 2011 TNT 208-5.
108 See §6.01(2) of the Appendix of Rev. Proc. 2011-14, applicable to taxpayers changing from impermissible depreciation methods.
111 §8.02(6) and 4.02(7) of Rev. Proc. 2011-14.
114 Id.
Appendix, the taxpayer has the opportunity to change to the optimal method retroactively to the first day of the taxable year for which it is filing the return (the application also would be timely for the taxpayer’s current taxable year).

Despite the availability of the extended filing deadline, however, a taxpayer should always consider filing a copy of application with the IRS National Office as soon as it decides it wants to change its method of accounting because the scope limitations are applied when the taxpayer files the copy of the application with the IRS National Office, not later when it files the original with its federal income tax return.\(^\text{117}\) Thus, the taxpayer obtains “audit protection” as soon as it files the copy of the application with the IRS National Office.\(^\text{118}\) In other words, if the taxpayer is contacted by an IRS examining agent after it files the copy of the application with the IRS National Office, the taxpayer is not prevented from making the change by reason of the “under examination” scope limitation.

**Review by Director**

As with changes made under the advance consent procedure, despite the taxpayer having “audit protection,” the director will determine whether the taxpayer complied with all of the applicable provisions of the automatic consent procedure.\(^\text{119}\) If the director determines that the taxpayer did not comply with all the applicable provisions of the automatic consent procedure, the director may:

- Deny the change and require the taxpayer to continue to use its prior method of accounting;
- Deny the change and place the taxpayer on a proper method of accounting; or
- Make any adjustments (including the amount of the §481(a) adjustment) that are necessary to bring the change into compliance with all the applicable provisions of the automatic consent procedure.\(^\text{120}\)

On the other hand, if the taxpayer complied with all of the applicable provisions of the automatic consent procedure, the director must apply the change in method of accounting in determining the taxpayer’s federal income tax liability, unless the director recommends to the IRS National Office that the change should be modified or revoked.\(^\text{121}\) As discussed above, the director makes such a referral under the procedures for obtaining technical advice.\(^\text{122}\)

**Review by the IRS National Office**

Although it will not issue the taxpayer a ruling, the IRS National Office may review the application.\(^\text{123}\) If the IRS National Office requests the taxpayer to provide additional information and the taxpayer does not provide the information on a timely basis, the IRS National Office will notify the taxpayer that the Commissioner does not grant the taxpayer consent to make the change.\(^\text{124}\) Furthermore, if the IRS National Office tentatively determines that the taxpayer did not comply with all the applicable provisions of the automatic consent procedure, it will offer the taxpayer a conference in which to persuade the Commissioner otherwise, if the taxpayer requested such a conference in its application.\(^\text{125}\)

If the Commissioner ultimately determines that the taxpayer did not follow all of the applicable provisions of the automatic consent procedure, the IRS National Office will notify the taxpayer that the Commissioner does not grant the taxpayer consent to make the change. The IRS National Office will not thereafter process the taxpayer’s application under the advance consent procedure.\(^\text{126}\) Instead, if the taxpayer still wants to change its method of accounting, it must file a new application under those procedures, which may result in a later year of change. Alternatively, the IRS National Office, in its discretion, may permit a taxpayer that did not follow all the applicable provisions

\(^{117}\) See §4.02(1) of Rev. Proc. 2011-14 ("If, on the date the taxpayer . . . would otherwise file a copy of the application with the national office, . . . the taxpayer is under exam. . . .") The IRS Office of Chief Counsel recently clarified that, if the Appendix waives the duplicate filing requirement, a taxpayer that wants to use the 90-day or 120-day window period nevertheless can file a copy of the application with the IRS National Office in the window period to satisfy the under examination scope limitation. CCA 201145013. This rule seemingly also would apply to a taxpayer that is not currently under examination that wants to file the application with the IRS National Office to begin its audit protection.

\(^{118}\) §7.01 of Rev. Proc. 2011-14.


\(^{120}\) §9.02 of Rev. Proc. 2011-14.

\(^{121}\) §§9.01 and 9.03 of Rev. Proc. 2011-14. See the discussion above regarding the controversy about whether the examining agent is correcting the taxpayer’s implementation of the change or modifying or revoking the change.


\(^{123}\) §10.01 of Rev. Proc. 2011-14.

\(^{124}\) §10.02(2) of Rev. Proc. 2011-14.

\(^{125}\) §10.03(1) of Rev. Proc. 2011-14. As noted above, the taxpayer makes the request by checking box 16 on the Form 3115. For the conference procedures, refer to Rev. Proc. 2011-1.

\(^{126}\) §10.03(2) of Rev. Proc. 2011-14.
of the automatic consent procedures to (a) make appropriate adjustments to conform its change to the applicable provisions (for example, modify its method of accounting to the method described in the Appendix), and (b) amend any affected federal income tax returns.\(^\text{127}\)

**Practice Tip:** If the IRS National Office reviews a taxpayer’s application filed under the automatic consent procedures and determines that the taxpayer complied with all the applicable provisions of the automatic consent procedures, the IRS National Office will not issue the taxpayer a ruling to that effect. In fact, the IRS National Office might never contact the taxpayer. Thus, such a review in the IRS National Office does not afford the taxpayer any greater certainty than if the IRS National Office did not review the application. Moreover, the director can later review the same application and determine that the taxpayer did not comply with all the applicable provisions of the automatic consent procedure and deny the taxpayer the change without seeking advice from the IRS National Office. Thus, the automatic consent procedure affords the IRS “two bites at the apple.”

### AN INvoluntary Change

If a taxpayer has not regularly used a method of accounting, or if the method it uses does not clearly reflect its income, the Commissioner may compute the taxpayer’s income using any method that, in the opinion of the Commissioner, does clearly reflect income.\(^\text{128}\) Courts give great deference to the Commissioner’s determination of whether the proposed method of accounting clearly reflects the taxpayer’s income,\(^\text{129}\) and have held that the Commissioner can change a taxpayer to a method of accounting that the taxpayer could not have even elected on its own.\(^\text{130}\) Courts will uphold the Commissioner’s determination unless it is “clearly unlawful” or “plainly arbitrary.”\(^\text{131}\)

**Practice Tip:** The Commissioner generally will not initiate an involuntary change in method of accounting if the change will result in a taxpayer-favorable §481(a) adjustment.\(^\text{132}\) However, if an examining agent audits a number of interrelated issues, some of which produce favorable adjustments and others unfavorable adjustments, the examining agent may net the §481(a) adjustments, and should do so.\(^\text{133}\)

When changing a taxpayer’s method of accounting (or otherwise resolving an accounting method issue), the Commissioner follows the provisions in the involuntary change procedure, Rev. Proc. 2002-18.\(^\text{134}\) Those provisions generally require the Commissioner to notify the taxpayer in writing, preferably in a closing agreement under §7121, that he is resolving the accounting method issue by changing the taxpayer’s method of accounting.\(^\text{135}\) The notice must include either a statement that the Commissioner is changing the taxpayer’s method of accounting or a clearly labeled §481(a) adjustment and it must include a description of the new method of accounting.\(^\text{136}\) If the Commissioner provides the required notice but does not impose a §481(a) adjustment, the change will be deemed to have been made using a cut-off method,\(^\text{137}\) unless the Commissioner and the taxpayer have agreed in writing to compromise the amount of the §481(a) adjustment.\(^\text{138}\)

\(^\text{127}\) §10.03(3) of Rev. Proc. 2011-14.

\(^\text{128}\) §446(b).


\(^\text{130}\) *Ford Motor Company v. Comr.*, 71 F.3d 209 (6th Cir. 1995) (court approved change to what was effectively the cash method of accounting for the item, even though taxpayer otherwise was not permitted to use the cash method for the item).

\(^\text{131}\) *Thor Power Tool Co.*, above.

\(^\text{132}\) The tax policy reason, as advanced by the Treasury Department, for the Commissioner not making taxpayer-favorable accounting method changes as part of an IRS examination is that a taxpayer cannot make a retroactive change in method of accounting under either the advance consent procedure or the automatic consent procedure. Therefore, if a taxpayer could retroactively change its method of accounting under the involuntary change procedure, a taxpayer under examination would receive more favorable terms and conditions than a taxpayer that is not under examination. The reason that the involuntary change procedure provides that the examining agent generally must make the change in the earliest taxable year under examination is to encourage taxpayers to voluntarily change from impermissible methods of accounting. Annette Smith, Treasury Deputy to the Tax Legislative Counsel, interview with *Tax Notes Today* (Sept. 21, 1998), 98 *TNT* 182-4.

\(^\text{133}\) TAM 199942002 (While an examining agent, in his discretion, generally determines the scope of an audit, he may be required to make certain interrelated adjustments in situations where he has conducted an examination.) See also Annette Smith, Treasury Deputy to the Tax Legislative Counsel, interview with *Tax Notes Today* (Sept. 21, 1998), 98 *TNT* 182-4 (“The policy to ‘ordinarily’ not initiate favorable changes ‘is not an absolute when the adjustments are so interrelated.’”).

\(^\text{134}\) 2002-1 C.B. 678.

\(^\text{135}\) §§7.01 and 7.02(1) of Rev. Proc. 2002-18. Appendix A of Rev. Proc. 2002-18 provides a Model Closing Agreement.

\(^\text{136}\) *Id.*

\(^\text{137}\) See n. 50 and associated text above for a definition of a “cut-off method.”

Once the change becomes final, the taxpayer must use the new method of accounting in all federal income tax returns it files after that date, unless it receives the consent of the Commissioner to change the method of accounting or the Commissioner changes it as the result of a subsequent examination. If the taxpayer does not use the new method of accounting in the intervening taxable years, the Commissioner will make adjustments necessary to reflect the change if and when he examines those years.

**Practice Tip:** A taxpayer that challenges a proposed change in method of accounting may continue to file its federal income tax returns on its present method of accounting until the change becomes final. Before the accounting method change becomes final and the taxpayer begins using the new method of accounting, the taxpayer might have several intervening years in which it did not use the new method of accounting. If the statute of limitations closes on the intervening years before the Commissioner makes any adjustments to conform the taxpayer’s method of accounting, the Commissioner likely cannot make a §481(a) adjustment in the current or any future years with respect to the method used in the intervening years. This is because the accounting method change became final with respect to the earlier year of change, and, therefore, there is no accounting method change to make in the current or any future taxable years.

The Commissioner may change the taxpayer from the new method of accounting in a subsequent examination, if the Commissioner determines that the new method of accounting does not clearly reflect the taxpayer’s income. If the taxpayer executes a closing agreement finalizing the change, however, the Commissioner will not change or modify the new method of accounting for any year for which the taxpayer has filed a federal income tax return as of the date of the closing agreement, provided that: (i) the taxpayer has complied with all the applicable provisions of the closing agreement, (ii) the taxpayer has not committed fraud, malfeasance, or misrepresented a material fact, (iii) there has been no change in the material facts on which the closing agreement was based; and (iv) there has been no change in the applicable law on which the closing agreement was based.

**Practice Tip:** Although the Commissioner is not precluded from changing the taxpayer from the new method of accounting in a subsequent examination, he may do so only if the taxpayer’s method of accounting does not clearly reflect its income. Given that the Commissioner placed the taxpayer on the method of accounting, unless the law or the taxpayer’s facts have changed subsequent to the original examination, the Commissioner is likely to have significant difficulty in establishing that the method upon which he placed the taxpayer does not clearly reflect the taxpayer’s income.

**Default Procedures**

If the Commissioner does not provide the taxpayer with the required notice of the change in method of accounting, the Commissioner will not have changed the taxpayer’s method of accounting. In such a case, the taxpayer and the Commissioner must treat all items in a manner that prevents the duplication or omission of items of income or deduction, the taxpayer is required to continue to use its present method of accounting for all items not affected by the adjustments imposed by the Commissioner, and if either the taxpayer or the Commissioner subsequently changes the taxpayer’s method of accounting, the §481(a) adjustment will take into account all items arising prior to the year of change (excluding the items affected by the adjustment made by the Commissioner).

**Different Levels of Authority**

Because Appeals officers and counsel for the government have wider discretion to resolve controver-

---

139 The change becomes final on the date the taxpayer and the Commissioner execute the closing agreement or the taxpayer uses the new method of accounting in filing a federal income tax return. Otherwise, the change becomes final upon the expiration of the period of limitations for filing a claim for refund under §6511 for the year of change, or the date of a final court order requiring the change. §§7.02(1) and 7.03(3) of Rev. Proc. 2002-18.

140 §§7.03(3) and 7.04(1) of Rev. Proc. 2002-18.

141 Id.

142 See TAM 199928001 (Commissioner cannot change taxpayer’s method after earlier change became final, even though taxpayer did not use the new method in the intervening years). The IRS and Treasury Department were considering addressing this issue in formal guidance. Announcement 2002-37, 2002-1 C.B. 703.

143 §7.04(2) of Rev. Proc. 2002-18.


145 See Klein Chocolate Co. v. Comm., 36 T.C. 142 (1961) (taxpayer’s use of a single inventory pool permitted over the Commissioner’s objection because the Commissioner previously had examined and approved the method and the taxpayer had consistently used the method since that time).

146 §7.02(4) of Rev. Proc. 2002-18.

147 §9.02 of Rev. Proc. 2002-18. An example applying these provisions is provided in §10.05 of Rev. Proc. 2002-18.
sies than examining agents have, the involuntary change procedure provides different rules for each.

Examining Agents

If an examining agent, using his professional judgment, determines that the taxpayer’s method of accounting is not permitted (or changed its method of accounting without obtaining the consent of the Commissioner), the examining agent may propose an adjustment with respect to that method only by changing the taxpayer’s method of accounting. The examining agent must change the taxpayer to a permissible method of accounting and not a method contrived to reflect the hazards of litigation. The examining agent is directed to determine a permissible method of accounting by “properly applying the law to the facts determined by the agent.”

Practice Tip: The examining agent’s discretion to select the new method of accounting may be limited if the year in which the taxpayer adopted the erroneous method is not closed by the statute of limitations. If the examining agent disallows the use of an impermissible method for the first taxable year for which the taxpayer attempts to use the method, he thereby prevents its adoption. Because taxpayers initially can adopt any permissible method of accounting, if the examining agent prevents the taxpayer from adopting a method, he should permit the taxpayer to adopt another method of its choosing.

The examining agent must make the change for a year under examination, and generally must do so in

148 §§5.01 and 5.02 of Rev. Proc. 2002-18.
149 The examining agent, however, may change the taxpayer back to an impermissible method of accounting if the taxpayer changed from that method without obtaining the consent of the Commissioner. §§2.06 and 5.03 of Rev. Proc. 2002-18. But see FSA 200102004 (Commissioner should not change the taxpayer from a permissible method back to an impermissible method without obtaining the consent of the Commissioner and there was no tax avoidance involved). The examining agent must change the taxpayer to a proper method of accounting when the Commissioner disallowed the taxpayer’s initial, impermissible depreciation method, and Mamula v. Commr., 346 F.2d 1016 (9th Cir. 1965) (taxpayer did not making binding election when initial method was impermissible).

150 §5.03 of Rev. Proc. 2002-18. Within the IRS, the determination of the hazards of litigation is the exclusive province of appeals and counsel for the government, and they forcefully defended their turf during the drafting of the involuntary change procedure.
151 §5.03 of Rev. Proc. 2002-18. See n. 50 and associated text above for a definition of a “cut-off method.”
152 §5.04(1) of Rev. Proc. 2002-18.
153 Id.
154 §5.04(2) of Rev. Proc. 2002-18. See n. 50 and associated text above for a definition of a “cut-off method.”
155 §5.04(3) of Rev. Proc. 2002-18.
156 IRM 8.1.1.1 (10-23-2007).
157 For ease of reference, “Appeals officer,” as used in this section, includes counsel for the government.
158 IRM 8.1.1.3 (10-23-2007).
159 For ease of reference, “Appeals officer,” as used in this section, includes counsel for the government.
162 §6.02(2) of Rev. Proc. 2002-18.
164 §6.02(2)(c)(i) of Rev. Proc. 2002-18. The author understands that the IRS currently is reviewing whether an Appeals officer’s discretion to defer the year of change be limited to

Appeals Officers and Counsel for the Government

Because of their mission to “resolve controversies, without litigation,” Appeals officers have much greater authority to resolve accounting method issues and can do so “when it is in the interest of the government to do so.” The involuntary revenue procedure provides examples of three different types of resolutions, but they are not exclusive. An Appeals officer may resolve an accounting method issue using “any other means deemed appropriate under the circumstances, to reflect the hazards of litigation.”

Accounting Method Change

Like an examining agent, an Appeals officer may change a taxpayer’s method of accounting, and also must change the taxpayer to a proper method of accounting. However, unlike an examining agent, an Appeals officer may alter the terms and conditions under which the taxpayer must make the change. For example, an Appeals officer can defer the year of change. Ordinarily, an Appeals officer will not defer the year of change to a year later than the most recent taxable year under exam. But in appropriate circumstances, the Appeals officer may defer the year of change to as late as the current taxable year.

An Appeals officer may impose a §481(a) adjustment or make the change using a cut-off method, and

the earliest year under examination, or if later, the earliest year in which the taxpayer’s method is impermissible. The examining agent may defer the year of change, however, in “appropriate circumstances,” such as when the taxpayer’s books and records are insufficient to compute a §481(a) adjustment in the earlier year (and the examining agent cannot reasonably estimate the adjustment). The examining agent ordinarily must compute a §481(a) adjustment and not use a “cut-off method” to reflect the hazards of litigation. Examining agents must take the §481(a) adjustment entirely into account in the year of change.
if he imposes a §481(a) adjustment, an Appeals officer may compromise the amount of the §481(a) adjustment and spread it over any appropriate number of years.\textsuperscript{165}

**Alternative-Timing Resolution**

Instead of changing a taxpayer’s method of accounting, an Appeals officer may resolve an accounting method issue by agreeing to an alternative-timing resolution.\textsuperscript{166} Under such a resolution, the taxpayer will treat the items arising during (or prior to and during) the taxable years before Appeals differently than it did under its method of accounting. The taxpayer will continue to use its method of accounting for all items not affected by the resolution (including items arising in subsequent taxable years).\textsuperscript{167} For example, if the taxpayer and an examining agent disagreed over whether certain costs were deductible or includible in the cost of the taxpayer’s inventory, the Appeals officer and the taxpayer could resolve the issue by the taxpayer including the disputed costs in the taxpayer’s inventory for the years before Appeals, but continue to deduct the costs in subsequent taxable years under its present method of accounting.\textsuperscript{168}

**Time-Value of Money Resolution**

Another alternative to changing the taxpayer’s method of accounting that an Appeals officer may use to resolve an accounting method issue is to have the taxpayer pay the government a “specified amount” that approximates the time-value-of-money benefit the taxpayer has received from using its method of accounting rather than the method of accounting proposed by the Appeals officer, reduced to reflect the hazards of litigation.

For example, if a taxpayer deducted the cost of a repair rather than capitalizing and depreciating it over five taxable years, the taxpayer had the use of the money that it would have paid in additional federal income tax in the year of deduction, offset by the additional federal income tax it paid in the subsequent taxable years because it had no depreciation in those years. The benefit the taxpayer received from paying the tax later than it otherwise would have paid it can be quantified and then reduced to reflect the hazards of litigation.

---

A methodology for computing the specified amount is set forth in the involuntary change procedure.\textsuperscript{169} The involuntary change procedure illustrates the methodology with an example that is summarized in the table below.\textsuperscript{170}

<table>
<thead>
<tr>
<th>Specified Amount</th>
<th>Hypothetical Underpayment/ (Overpayment) \textsuperscript{171}</th>
<th>Interest Rate</th>
<th>Tax Rate</th>
<th>Applicable Time-Value Rate \textsuperscript{172}</th>
<th>Beginning Date</th>
<th>Ending Date</th>
<th>Applicable Period (Days) \textsuperscript{173}</th>
<th>Suitable Amount</th>
<th>IRS Hazards</th>
<th>Settlement</th>
</tr>
</thead>
<tbody>
<tr>
<td>$160,519</td>
<td>$1,050,000</td>
<td>10.10%</td>
<td>35%</td>
<td>0.06565%</td>
<td>March 15, 1998</td>
<td>May 15, 2000</td>
<td>792</td>
<td>$161,763</td>
<td>25%</td>
<td>$120,389</td>
</tr>
</tbody>
</table>

In the example, the taxpayer will pay the government $161,763 (which the taxpayer cannot deduct), the Commissioner will not change (or impose any adjustments with respect to) the taxpayer’s method of accounting, and the taxpayer will continue to use its present method of accounting.\textsuperscript{175} Neither the Commissioner nor the taxpayer is prohibited from later

---

\textsuperscript{165} §6.02(2)(c)(ii) and (iii) of Rev. Proc. 2002-18.
\textsuperscript{166} §6.02(3) of Rev. Proc. 2002-18.
\textsuperscript{167} Id.
\textsuperscript{168} Id.
\textsuperscript{169} §6.02(4)(b)(ii) of Rev. Proc. 2002-18.
\textsuperscript{170} §10.04 of Rev. Proc. 2002-18.
\textsuperscript{171} The hypothetical underpayment/(overpayment) simply is the proposed adjustment multiplied by the highest tax rate applicable to the taxpayer. §6.02(4)(b)(ii)(A) of Rev. Proc. 2002-18.
\textsuperscript{172} The applicable time-value rate is the average of the quarterly underpayment rates in effect under §6621(a) for the applicable period. The rate is reduced if the taxpayer would be entitled to deduct interest on the underpayment of tax. The formula for reducing the rate is the interest rate multiplied by the excess of 100% over the applicable tax rate. §6.02(4)(b)(ii)(A) of Rev. Proc. 2002-18.
\textsuperscript{173} The applicable period (days) begins on the due date (without regard to extensions) of the federal income tax return for the taxable year of the hypothetical underpayment/(overpayment) and ends on the date the taxpayer pays the specified amount. §6.02(4)(b)(ii)(C) of Rev. Proc. 2002-18.
\textsuperscript{174} The specified amount is computed using the following formula: \( U * \left( \frac{[[1+(r/365)]^n-1]}{r} \right) \).

Where \( U \) is the hypothetical underpayment for the taxable year, \( r \) is the applicable time-value rate, and \( n \) is the number of days in the applicable period. §10.04(2) of Rev. Proc. 2002-18.

The following is the Excel formula: \( \text{FV}(r,n,,-U,0)-U \) (note: \( r \) must first be divided by 365).
\textsuperscript{175} §8.03(2) of Rev. Proc. 2002-18.
changing the taxpayer’s method of accounting. If either does, the §481(a) adjustment arising from the change will take into account all items arising prior to the year of change. However, if the Commissioner later changes the taxpayer’s method of accounting and imposes a §481(a) adjustment, any interest will be treated as paid to the extent necessary to prevent duplicate payment of the time-value-of money benefit relating to the §481(a) adjustment.

Closing Agreement Necessary

If an Appeals officer resolves an accounting method issue on a non-accounting method change basis (an alternative timing, time-value of money, or other type of resolution), the Commissioner and the taxpayer must enter into a closing agreement under §7121. The closing agreement must comply with the provisions of Rev. Proc. 68-16 and include the information outlined in the Model Closing Agreement, attached as Appendix B to the involuntary change procedure.

A CHANGE IN A §381(a) TRANSACTION

Because a taxpayer must use its methods of accounting consistently, accounting method issues can arise when a taxpayer engages in a transaction to which §381(a) applies. For example, if X Corporation and T Corporation use different methods of accounting for advance payments and X Corporation merges with T Corporation into one integrated trade or business, either X Corporation or T Corporation must change its method of accounting for advance payments so that the integrated taxpayer will use one method of accounting for all of the advance payments it receives after the merger. Therefore, if a taxpayer engages in a transaction to which §381(a) applies, the taxpayer must determine what methods of accounting it must use (including the overall method and any special methods within the overall method) and whether it must change any of its methods of accounting to use the required method.

Separate Trades or Businesses

If following a transaction to which §381(a) applies a taxpayer will continue to operate the trades or businesses of the distributor or transferor corporation and the acquiring corporation as separate and distinct, then each of the separate trades or businesses generally must continue to use their existing method of accounting (the “carryover method”). The carryover method is the method of accounting the trade or business was using immediately prior to the date of distribution or transfer.

To be a separate and distinct trade or business, at a minimum, the taxpayer must maintain a complete and separable (not necessarily separate) set of books and records for such trade or business. In addition, if by reason of maintaining different methods of accounting, there is a creation or shifting of profits or losses between the trades or businesses so that the income of the taxpayer is not clearly reflected, the trades or businesses will not be considered separate and distinct.

The determination of whether the taxpayer will operate the trades or businesses as separate and distinct is made on the date of distribution or transfer based upon the facts and circumstances. The regulations appear to make the determination based on the taxpayer’s intent. Thus, if, as of the date of the distribution or transfer, the taxpayer’s intent is to integrate the trades or business, the regulations may treat them as integrated, even if the integration is not complete by the end of the year that includes the date of distribution or transfer.

If the carryover method is not a permissible method (or the taxpayer simply does not want to use the carryover method), the taxpayer must request the consent procedure. Regs. §§1.381(c)(6)-1(e).

Section 381(a) applies to the sale or distribution of a business or trade, the sale or assignment of property used in a trade or business, and the transfer of a corporation under §332 and certain tax-free reorganizations under §361.

Separate Trades or Businesses

If following a transaction to which §381(a) applies a taxpayer will continue to operate the trades or businesses of the distributor or transferor corporation and the acquiring corporation as separate and distinct, then each of the separate trades or businesses generally must continue to use their existing method of accounting (the “carryover method”). The carryover method is the method of accounting the trade or business was using immediately prior to the date of distribution or transfer.

To be a separate and distinct trade or business, at a minimum, the taxpayer must maintain a complete and separable (not necessarily separate) set of books and records for such trade or business. In addition, if by reason of maintaining different methods of accounting, there is a creation or shifting of profits or losses between the trades or businesses so that the income of the taxpayer is not clearly reflected, the trades or businesses will not be considered separate and distinct.

The determination of whether the taxpayer will operate the trades or businesses as separate and distinct is made on the date of distribution or transfer based upon the facts and circumstances. The regulations appear to make the determination based on the taxpayer’s intent. Thus, if, as of the date of the distribution or transfer, the taxpayer’s intent is to integrate the trades or business, the regulations may treat them as integrated, even if the integration is not complete by the end of the year that includes the date of distribution or transfer.

If the carryover method is not a permissible method (or the taxpayer simply does not want to use the carryover method), the taxpayer must request the consent procedure. Regs. §§1.381(c)(6)-1(e).

Sections 381(a) applies to the sale or distribution of a business or trade, the sale or assignment of property used in a trade or business, and the transfer of a corporation under §332 and certain tax-free reorganizations under §361.

Separate Trades or Businesses

If following a transaction to which §381(a) applies a taxpayer will continue to operate the trades or businesses of the distributor or transferor corporation and the acquiring corporation as separate and distinct, then each of the separate trades or businesses generally must continue to use their existing method of accounting (the “carryover method”). The carryover method is the method of accounting the trade or business was using immediately prior to the date of distribution or transfer.

To be a separate and distinct trade or business, at a minimum, the taxpayer must maintain a complete and separable (not necessarily separate) set of books and records for such trade or business. In addition, if by reason of maintaining different methods of accounting, there is a creation or shifting of profits or losses between the trades or businesses so that the income of the taxpayer is not clearly reflected, the trades or businesses will not be considered separate and distinct.

The determination of whether the taxpayer will operate the trades or businesses as separate and distinct is made on the date of distribution or transfer based upon the facts and circumstances. The regulations appear to make the determination based on the taxpayer’s intent. Thus, if, as of the date of the distribution or transfer, the taxpayer’s intent is to integrate the trades or business, the regulations may treat them as integrated, even if the integration is not complete by the end of the year that includes the date of distribution or transfer.

If the carryover method is not a permissible method (or the taxpayer simply does not want to use the carryover method), the taxpayer must request the consent procedure. Regs. §§1.381(c)(6)-1(e).

Sections 381(a) applies to the sale or distribution of a business or trade, the sale or assignment of property used in a trade or business, and the transfer of a corporation under §332 and certain tax-free reorganizations under §361.
of the Commissioner (under the advance consent procedure)\textsuperscript{189} to change to a permissible method of accounting.\textsuperscript{190}

In addition, if a taxpayer is not permitted to use a special method of accounting for separate trades or businesses (for example, if it makes an election under §171 to amortize bond premium, the taxpayer must use the method for all its trades or businesses), the taxpayer must use the “principal” method for the item (if it is a permissible method) for all its trades or businesses.\textsuperscript{191} The “principal” method is the method used by the acquiring corporation’s trades or businesses,\textsuperscript{192} unless the distributor or transferor’s trades or businesses are larger than the acquiring corporation’s trades or businesses.\textsuperscript{193}

Generally, a distributor or transferor’s trade or business is larger than the acquiring corporation’s trade or business only if both the aggregate of the adjusted bases of the assets is greater and the aggregate of the gross receipts for the 12 months preceding the transaction is greater.\textsuperscript{194} If one of the trades or businesses was in existence for less than 12 months, the period is reduced to the number of months the trade or business was in existence.\textsuperscript{195}

With respect to inventory methods, the principal method is determined for each particular type of goods. Generally, the principal method is the inventory method used by the component trade or business of the acquiring corporation. If, however, the component trade or business of the distributor or transferor corporation holds more inventory of a type of goods (determined based on the aggregate of the fair market value of the goods), the principal method is the inventory method used by the component trade or business of the distributor or transferor corporation. As a simplifying convention, the acquiring corporation may make the determination based on the aggregate of the fair market values of the entire inventories of the component trades or businesses. However, if the component trade or business with the larger entire inventories does not have a method of accounting for a particular type of goods, the principal method for that type of goods is the method used by the component trade or business that does have a method of accounting for that type of goods.\textsuperscript{196}

A taxpayer does not need the consent of the Commissioner to use the principal method, even if it will require one or more trades or businesses to change their method of accounting.\textsuperscript{197} If, however, the principal method is not a permissible method, the taxpayer must request the consent of the Commissioner (under the advance consent procedure) to change to a permissible method of accounting for all the trades or businesses.\textsuperscript{198}

### Integrated Trades or Businesses

If following a transaction to which §381(a) applies a taxpayer will integrate two or more of the trades or businesses of the distributor or transferor corporation and the acquiring corporation, the taxpayer generally must use the principal method of accounting for the trades or businesses that it integrates.\textsuperscript{199} The taxpayer does not need to obtain the consent of the Commissioner to use the principal method.\textsuperscript{200} However, if the principal method of accounting is not a permissible method (or the taxpayer simply does not want to use the principal method), the taxpayer must request the consent of the Commissioner (under the advance consent procedure) to change to a permissible method.\textsuperscript{201}

As discussed above, the principal method is the method used by the acquiring corporation’s trades or businesses, unless the distributing or transferor corporation’s trades or businesses (or inventories) are larger.\textsuperscript{202} The determination is made for each integrated trade or business.\textsuperscript{203}

**Example:** Assume X Corporation merges with and into T Corporation. Before the merger, X Corporation and T Corporation each had separate manufacturing and sales trades or businesses. After the merger, T Corporation (the acquiring corporation) will continue to...
operate the manufacturing and sales trades or businesses separately, but it will integrate the two manufacturing trades or businesses and the two sales trades or businesses. T Corporation must use its methods of accounting for the integrated manufacturing trade or business, unless X Corporation’s manufacturing trade or business is larger than T Corporation’s manufacturing trades or businesses, in which case it would use X Corporation’s methods of accounting for the manufacturing trade or business. Separately, T Corporation must use its methods of accounting for the integrated sales trade or business, unless X Corporation’s sales trade or business is larger than T Corporation’s sales trade or business, in which case it would use X Corporation’s methods of accounting for the sales trade or business.

If the larger trade or business does not have a special method of accounting for an item (for example, if the larger trade or business previously did not receive advance payments, it would not have a method of accounting for advance payments), the principal method of accounting is the method used by the trade or business. If as a result of one or both of the parties to the transaction having multiple trades or businesses there are different principal methods, the taxpayer may choose which of the principal methods to use as the principal method of the integrated trades or businesses (but it must choose a permissible method).

Example: Assume X Corporation has a manufacturing trade or business and a sales trade or business. X Corporation’s manufacturing business uses an accrual method and X Corporation’s sales business uses the cash receipts and disbursements method of accounting. X Corporation acquires T Corporation, which has a manufacturing trade or business. After the transaction, X will integrate all the trades or businesses. If T Corporation’s manufacturing trade or business is smaller than X Corporation’s combined trades or businesses, X Corporation’s methods of accounting will be the principal methods. Because X Corporation has two principal overall methods of accounting, X Corporation can choose which principal method to use, but it can only choose a method of accounting that is a permissible method. Because the combined trades or businesses must use an accrual method of accounting, X Corporation must choose the manufacturing trade or business’ overall accrual method as the principal method.

Although a taxpayer that integrates its trades or businesses can request the consent of the Commissioner to change its method of accounting for the year of the transaction (under the advance consent procedure), the Commissioner will grant his consent only if the taxpayer is requesting consent to change to the method of accounting that the acquiring corporation must use after the transaction.

Terms and Conditions

As discussed above, following a transaction to which §381(a) applies, a taxpayer may use the principal method without requesting the Commissioner’s consent. To the extent the use of the principal method requires the taxpayer to change its method of accounting (either with respect to the distributor or transferor corporation’s trade or business or the acquiring corporation’s own trade or business), the change must be reflected on the taxpayer’s federal income tax return for the taxable year that includes the date of distribution or transfer. The amount of the §481(a) adjustment and the spread period for the §481(a) adjustment (if any) are the same as they would be if the taxpayer made the same change under the advance consent procedure. The §481(a) adjustment, however, is computed as of the beginning of the day immediately after the date of distribution or transfer.

The use of the principal method (and a change to the principal method) without requesting the consent of the Commissioner is without audit protection. For example, assume that X Corporation is using an impermissible overall cash receipts and disbursements method. Because the combined trades or businesses must use an accrual method of accounting, X Corporation must choose the manufacturing trade or business’ overall accrual method as the principal method.

204 Regs. §§1.381(c)(4)-1(c)(1) and 1.381(c)(5)-1(c)(1).
205 Regs. §§1.381(c)(4)-1(c)(2) and 1.381(c)(5)-1(c)(2).
206 Regs. §§1.381(c)(4)-1(a)(5) and 1.381(c)(5)-1(a)(5).
207 Id. 
208 Id.
209 If the taxpayer would make the change under the advance consent procedure using a cut-off method, the taxpayer must implement the change under the §381 regulations using a cut-off method.
210 Id. Similarly, the other terms and conditions (such as a shortened §481(a) adjustment period under certain circumstances) also apply, but not the scope limitations. Regs. §§1.381(c)(4)-1(d)(1)(ii) and 1.381(c)(5)-1(d)(1)(ii).
211 Id.
212 Regs. §§1.381(c)(4)-1(d)(1)(i) and 1.381(c)(5)-1(d)(1)(i).
method of accounting and changes to the principal method, a permissible overall accrual method, following a transaction to which §381(a) applies. On audit, the Commissioner can change X Corporation to a permissible overall accrual method in an earlier year because X Corporation does not receive audit protection when changing to the principal method.

**Practice Tip:** A taxpayer can obtain audit protection by requesting the consent of the Commissioner to change to the principal method under the advance consent procedure.213

### Voluntary Changes

As discussed above, if the carryover or principal method is impermissible, or the taxpayer simply does not want to use the carryover or principal method, the taxpayer can request the consent of the Commissioner, under the advance consent procedure, to use a different method.214 Any scope limitation with respect to the final year of a trade or business215 does not apply, but the other scope limitations do apply.216 In addition, the due date for filing the application is extended to the later of: (i) the ordinary due date for filing the application, or (ii) the earlier of (1) 180 days after the date of distribution or transfer, or (2) when the taxpayer files its federal income tax return for the taxable year in which the distribution or transfer occurred.217

**Practice Tip:** Because the scope limitations regarding taxpayers under examination are not waived, the due date for filing the application actually is the day before the taxpayer is contacted by an examining agent for purposes of scheduling an examination. Therefore, the deadline for filing the application is actually the day before the taxpayer is contacted by the examining agent, which is unknown. As a result, a taxpayer that is not currently under examination should consider filing the application as soon as possible after it decides to change its method of accounting.

**Practice Tip:** The Treasury and IRS understand that the current scope limitations in the advance consent procedure can result in a difficult situation for taxpayers that are under examination (or that become under examination) and are using an impermissible method of accounting that otherwise would be the principal method. Since the taxpayer cannot use an impermissible method, the taxpayer must request a change under the advance consent procedure. If the taxpayer is not in a window period, however, the only way the taxpayer can file the application is to obtain director consent. The director, however, might be reluctant to grant such consent because the director can impose the change on examination, with an earlier year of change and without a spread period for any §481(a) adjustment. Treasury and the IRS, therefore, currently are considering providing a new window period or other appropriate relief.218

### CONCLUSION

Although the accounting method change rules are complex, taxpayers need to have a working knowledge of them in order to ensure that they are using optimal and permissible methods of accounting. A broad understanding of the overall accounting method change landscape will help the taxpayer meet that responsibility. Moreover, because certainty is of paramount importance, when a taxpayer changes its method of accounting, it should carefully follow the appropriate accounting method change procedure. By doing so, the taxpayer will have greater assurance that the Commissioner will not later revoke his consent or otherwise change the taxpayer’s method of accounting.

213 See Regs. §§1.381(c)(4)-1(a)(5) and -1(d)(2) and 1.381(c)(5)-1(a)(5) and -1(d)(2).

214 Regs. §§1.381(c)(4)-1(a)(4) and -1(a)(5) and 1.381(c)(5)-1(a)(4) and -1(a)(5).

215 For example, §4.02(5) of Rev. Proc. 2011-14 would not apply.

216 Regs. §§1.381(c)(4)-1(d)(2)(i) and 1.381(c)(5)-1(d)(2)(i).

217 Regs. §§1.381(c)(4)-1(d)(3)(i) and 1.381(c)(5)-1(d)(2)(i).

218 Brandon Carlton, Treasury Associate Tax Legislative Counsel, Remarks at the District of Columbia Bar Association Tax Section Corporate Committee meeting (Oct. 4, 2011), as reported in 193 BNA Daily Tax Rpt. G-5 (10/5/11).