26 CFR 601.204 Changes in accounting periods and methods of accounting
(Also: Part I, §§ 461; 1.461-4; 481)

Rev. Proc. 2015-39

SECTION 1. PURPOSE

This revenue procedure provides a safe harbor under which a taxpayer using an accrual method of accounting may treat economic performance as occurring on a ratable basis for certain service contracts described in section 4.02 of this revenue procedure. This revenue procedure also provides procedures for obtaining the automatic consent of the Commissioner to change to the method of accounting described in this revenue procedure.

SECTION 2. BACKGROUND

.01 Section 461(a) of the Internal Revenue Code provides that the amount of any deduction or credit must be taken for the taxable year that is the proper taxable year under the method of accounting used in computing taxable income.

.02 Section 1.461-1(a)(2)(i) of the Income Tax Regulations provides that, under an accrual method of accounting, a liability is incurred, and generally taken into account for federal income tax purposes, in the taxable year in which (1) all the events have occurred that establish the fact of the liability, (2) the amount of the liability can be determined with reasonable accuracy (requirements (1) and (2) are collectively referred to as the "all events test"), and (3) economic performance has occurred with respect to the liability. *See also* § 1.446-1(c)(1)(ii)(A).

.03 All the events have occurred that establish the fact of the liability when (1) the event fixing the liability occurs, whether that is the required performance or other event, or (2) the payment is due, whichever happens earliest. Rev. Rul. 2007-3, 2007-1 C.B. 350; Rev. Rul. 80-230, 1980-2 C.B. 169; Rev. Rul. 79-410, 1979-2 C.B. 213, *amplified by* Rev. Rul. 2003-90, 2003-2 C.B. 353.

.04 Section 461(h)(1) and § 1.461-4(a)(1) provide that, for purposes of determining whether an accrual basis taxpayer can treat the amount of any liability as incurred, the all events test is not treated as met any earlier than the taxable year in which economic performance occurs with respect to the liability.

.05 Section 461(h)(2)(A)(i) provides that if the liability of a taxpayer arises out of the provision of services to the taxpayer by another person, economic performance occurs as the person provides those services. *See also* § 1.461-4(d)(2)(i).

.06 Neither § 461(h)(2)(A)(i) nor § 1.461-4(d)(2)(i) explain when a person has provided services for purposes of satisfying the economic performance requirement in the context of a Ratable Service Contract as described in section 4.02 of this revenue procedure.

.07 There are two exceptions to the general rule of economic performance in § 461(h)(2)(A) that allow a taxpayer to accelerate the accrual of a liability into a year prior to the year that the economic performance requirement is satisfied. These exceptions are the 3½ month rule and the recurring item exception.

.08 Under the 3½ month rule in § 1.461-4(d)(6)(ii), a taxpayer may treat economic performance as occurring as the taxpayer makes payment to the person providing the services if the taxpayer can reasonably expect the person to provide the services within 3½ months after the taxpayer makes the payment.

.09 Under the recurring item exception in § 461(h)(3)(A) and § 1.461-5(b), a liability is treated as incurred for a taxable year if: (i) at the end of the taxable year, all the events have occurred that establish the fact of the liability and the amount can be determined with reasonable accuracy; (ii) economic performance occurs on or before the earlier of (A) the date that the taxpayer files a timely return (including extensions) for the taxable year, or (B) the 15th day of the ninth calendar month after the close of the taxable year; (iii) the liability is recurring in nature; and (iv) either (A) the amount of the liability is not material or (B) the accrual of the liability in the taxable year results in a better matching of the liability with the income to which it relates than would result from accruing the liability for the taxable year in which economic performance occurs. *See*, Rev. Rul. 2012-1, 2012-1 I.R.B. 255.

.10 Section 1.461-4(d)(6)(iv) provides that if different services are required to be provided to the taxpayer under a single contract, economic performance occurs over the time each service is provided.

.11 In *Caltex Oil Venture v. Commissioner*, 138 T.C. 18, 36 (2012), the Tax Court construed the 3½ month rule as contemplating that all of the services called for under an undifferentiated, nonseverable contract must be provided within 3½ months of payment.

.12 Under § 446(b), the Commissioner has broad authority to determine whether a method of accounting clearly reflects income. Section 1.446-1(c)(2)(ii) provides that the Commissioner may authorize a taxpayer to adopt or change to a permissible method of accounting although the method is not specifically described in the regulations as permissible if, in the opinion of the Commissioner, that method clearly reflects income.

.13 Section 446(e) and § 1.446-1(e)(2)(i) state that, except as otherwise provided, a taxpayer must secure the consent of the Commissioner before changing a method of accounting for federal income tax purposes. Section 1.446-1(e)(3)(ii) authorizes the Commissioner to prescribe administrative procedures setting forth the limitations, terms, and conditions necessary to obtain the Commissioner's consent to effect the change in method of accounting and to prevent amounts from being duplicated or omitted.

.14 Section 481(a) requires adjustments necessary to prevent amounts from being duplicated or omitted by reason of a change in method of accounting.

.15 Rev. Proc. 2015-13, 2015-5 I.R.B. 419, provides the automatic change procedures by which a taxpayer may obtain consent to change to a method of accounting described in the List of Automatic Changes of Rev. Proc. 2015-14, 2015-5 I.R.B. 450.

SECTION 3. SCOPE

This revenue procedure applies to an accrual method taxpayer that wants to change its method of accounting for liabilities arising out of the provision of services to the taxpayer under a Ratable Service Contract, as defined in section 4.02 of this revenue procedure, to the safe harbor method provided in section 4.01 of this revenue procedure.

SECTION 4. SAFE HARBOR METHOD

.01 *In General*. Under the safe harbor method of accounting for Ratable Service Contracts, as defined in section 4.02, a taxpayer may treat economic performance as occurring on a ratable basis over the term of the service contract.

.02 *Ratable Service Contract*. For purposes of this revenue procedure, a contract is a Ratable Service Contract if: (1) the contract provides for similar services to be provided on a regular basis, such as daily, weekly, or monthly; (2) each occurrence of the service provides independent value, such that the benefits of receiving each occurrence of the service is not dependent on the receipt of any previous or subsequent occurrence of the service, and; (3) the term of the contract does not exceed 12 months (contract renewal provisions will not be considered in determining whether a contract exceeds 12 months). If a single contract includes services that satisfy the requirements of this section and services (or other items) that do not satisfy the requirements of this section, the services (or other items) that do not satisfy the requirements of this section must be separately priced in the contract for the contract to qualify as a Ratable Service Contract.

.03 *Examples*. The following examples illustrate the application of the safe harbor method of accounting for Ratable Service Contracts. In each example the taxpayer uses an accrual method of accounting for federal income tax purposes, including the use of the 3½ month rule and the recurring item exception, and files its returns on a calendar year basis.

Example 1. On December 31, 2015, Taxpayer enters into a one-year service contract with *X*. Under the contract, *X* will provide janitorial services on a daily basis to Taxpayer until the end of 2016. Under the contract, Taxpayer pays *X* $3,000 a month to clean Taxpayer's offices. The contract requires Taxpayer to pay for each month's service by the end of the prior month. On December 31, 2015, Taxpayer makes a $3,000 payment to *X* for the services to be provided in January 2016. Taxpayer reasonably expects *X* to provide the janitorial services in January. As of December 31, 2015, all events have occurred to establish the fact of Taxpayer's $3,000 contractually-required payment and the amount of the liability is determinable with reasonable accuracy.

The contract meets the requirements of a Ratable Service Contract in section 4.02 of this revenue procedure because the janitorial services are to be provided on a regular basis (daily); each daily occurrence of the janitorial service provides independent value, such that the benefits from each occurrence of the service are not dependent on the receipt of previous or subsequent janitorial services; and the contract term does not exceed 12 months. Under the provisions of this revenue procedure, Taxpayer may treat economic performance as occurring ratably under the contract. Thus, under the 3½ month rule Taxpayer is allowed to incur a liability in 2015 for the $3,000 paid in 2015. For the services provided from February through December 2016, economic performance occurs ratably as the services are provided to Taxpayer each day, and a liability of $33,000 for these services is incurred in 2016.

Example 2. On December 31, 2015, Taxpayer enters into a one-year service contract with *X*. Under the contract, *X* will provide landscape maintenance services to Taxpayer from January through December 2016 on a monthly basis. Under the contract Taxpayer pays *X* $4,000 a month to maintain Taxpayer's grounds. The contract requires Taxpayer to prepay for the twelve months of services with the full payment of $48,000 due on December 31, 2015. On December 31, 2015, Taxpayer makes the $48,000 payment to *X* for services to be provided from January 1, 2016, through December 31, 2016. As of December 31, 2015, all events have occurred to establish the fact of Taxpayer's $48,000 contractually-required payment and the amount of the liability is determinable with reasonable accuracy.

The contract meets the requirements of a Ratable Service Contract in section 4.02 of this revenue procedure because the maintenance services are to be provided on a regular basis (monthly); each occurrence of the maintenance service provides independent value, such that the benefits from each occurrence of the service are not dependent on the receipt of prior or subsequent maintenance services; and the contract term does not exceed 12 months. Under the provisions of this revenue procedure, Taxpayer may treat economic performance as occurring ratably under the contract. Assuming that Taxpayer satisfies the requirements of the recurring item exception, as described in section 2.09 of this revenue procedure, and files its return on September 15, 2016, Taxpayer is allowed to incur a liability in 2015 of $34,000 (8.5 months/12 months x $48,000) for the services provided from January 1 through September 15, 2016. For the services provided from September 16 through December 31, 2016, the period outside of the recurring item exception, economic performance occurs ratably as the services are provided to Taxpayer during that time and a liability for these services of $14,000 (3.5 months/12 months x $48,000) is incurred in 2016.

Example 3. On November 30, 2015, Taxpayer enters into a one-year contract for an environmental impact study with *Y.* Under the contract, *Y* must complete and deliver the study by November 30, 2016. In exchange, Taxpayer will pay *Y* $100,000 when the contract is signed and $400,000 when the study is delivered on November 30, 2016. Taxpayer makes the payments on the specified dates. *Y* performs work on the study during 2015 and 2016 and delivers the completed study to Taxpayer on November 30, 2016. On November 30, 2015, all the events have occurred that establish the fact of Taxpayer's contractually-required payment of $100,000 and the amount of Taxpayer's liability under the contract can be determined with reasonable accuracy.

The contract does not satisfy the definition of a Ratable Service Contract in section 4.02 of this revenue procedure because the contract does not provide for services to be provided on a regular basis. Rather, the contract specifies that *Y* will provide to Taxpayer only one service, namely a completed and delivered impact study. Each instance of *Y*'s work on the study during the contract period does not provide independent value to Taxpayer. Instead, each instance of work on the study is dependent on the previous and subsequent work on the study to achieve its completion. Thus, Taxpayer may not treat economic performance as occurring ratably over the term of the service contract pursuant to the safe harbor in section 4.02 of this revenue procedure and may not rely on the safe harbor to incur a liability for any portion of the $100,000 in 2015. Instead, economic performance occurs when the study is completed and a liability of $500,000 for this service is incurred upon its completion.

Example 4. On December 31, 2015, Taxpayer enters into a one-year service contract with *X*. Under the contract, *X* will provide various IT support and maintenance services to Taxpayer, such as providing help desk support to Taxpayer's employees and maintaining Taxpayer's existing software and web pages (IT services). The IT services will be provided on a daily basis through December 31, 2016. In addition, under the contract *X* will create an updated human resources software application for Taxpayer (HR software development service). Under the contract, Taxpayer will pay *X* a flat fee of $3,000 a month for the IT services and the HR software development service. The contract requires Taxpayer to pay for each month's services by the end of the prior month. On December 31, 2015, Taxpayer makes a $3,000 payment to *X* for the IT services and HR software development to be provided in January 2016. Taxpayer reasonably expects *X* to provide the IT services in January. As of December 31, 2015, all events have occurred to establish the fact of Taxpayer's $3,000 contractually-required payment and the amount of the liability is determinable with reasonable accuracy.

The contract does not meet the requirements of section 4.02 of this revenue procedure because the contract includes the HR software development service that is not provided on a regular basis. Under the terms of the contract, the HR software development service consists of only one service, an update to Taxpayer's human resources software application. Each instance of *X's* work on updating the software application during the contract period is dependent on the previous and subsequent work to complete the update and does not provide independent value to Taxpayer. Because the contract does not separately price the HR software development service, which does not meet the requirements for a Ratable Service Contract in section 4.02 of this revenue procedure, Taxpayer may not treat economic performance as occurring on a ratable basis over the term of the service contract pursuant to the safe harbor in section 4.02 of this revenue procedure.

Example 5. Same facts as *Example 4*, except that under the service contract the HR software development service is separately priced at $12,000, with $1,000 of the $3,000 monthly payment allocated to the software development service. The IT services described in the contract meet the requirements for a Ratable Service Contract in section 4.02 of this revenue procedure because the IT services are provided on a regular basis (daily); each daily occurrence of IT service provides independent value, such that the benefits from each occurrence of the service are not dependent on the receipt of prior or subsequent IT services; and the contract term does not exceed 12 months. Under the provisions of this revenue procedure, Taxpayer may treat economic performance for the IT services as occurring ratably under the contract. Taxpayer incurs a liability in 2015 for $2,000 of the $3,000 payment for IT services under the 3½ month rule. For the IT services provided from February through December 2016, economic performance occurs ratably as the services are provided to Taxpayer each day and a liability of $22,000 for these services is incurred in 2016. For the HR software development service liability, economic performance occurs when the service is completed and a liability of $12,000 for this service is incurred upon completion.

SECTION 5. CHANGE IN METHOD OF ACCOUNTING

.01 *In general*. A change in the treatment of Ratable Service Contracts to conform to the safe harbor method provided by this revenue procedure is a change in method of accounting to which the provisions of §§ 446 and 481 and the regulations thereunder apply. A taxpayer that wants to change to the method of accounting described in this revenue procedure must, if eligible, use the automatic change procedures in Rev. Proc. 2015-13 and Rev. Proc. 2015-14, or successors, as modified by section 5.02 of this revenue procedure.

.02 Rev. Proc. 2015-14 is modified to add new section 19.12 to the List of Automatic Changes to read as follows:

.12 Economic Performance Safe Harbor for Ratable Service Contracts.

(1) *Description of change.* This change applies to an accrual method taxpayer that wants to change its treatment of Ratable Service Contracts to conform to the safe harbor method provided by Rev. Proc. 2015-39, 2015-33 I.R.B. ___.

(2) *Eligibility rule temporarily inapplicable*. The eligibility rule in section 5.01(1)(f) of Rev. Proc. 2015-13, does not apply to a taxpayer that wants to make a change for a taxpayer's first, second, or third taxable years ending on or after July 30, 2015.

(3) Designated automatic accounting method change number. The designated automatic accounting method change number for changes in methods of accounting under this section 19.12 is “220.”

(4) *Contact information*. For further information regarding a change under this section, contact David Christensen or Peter Ford at 202-317-7011 (not a toll-free call).

SECTION 6. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 2015-14 is modified to add new section 19.12 to the List of Automatic Changes.

SECTION 7. REQUEST FOR COMMENTS

Section 461(h)(2)(A) and § 1.461-4(d)(2)(i) do not define the phrase “as services are provided” for purposes of determining when economic performance occurs for liabilities arising from services to be provided to the taxpayer by another person. The Treasury Department and the Internal Revenue Service invite comments regarding when economic performance occurs for liabilities arising from services to be provided to the taxpayer by another person under contracts for: (1) deliverable-type services that are not completed on a periodic basis, (2) multiple services that are not separately priced, and (3) Ratable Service Contracts that are longer than one year.

Comments may be submitted in writing on or before November 15, 2015. Comments should be submitted to Internal Revenue Service, CC:PA:LPD:PR (Rev. Proc. 2015-39), Room 5203, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044, or electronically to Notice.comments@irscounsel.treas.gov. Please include Rev. Proc. 2015-39 in the subject line of any electronic communication.

Alternatively, comments may be hand delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (Rev. Proc. 2015-39), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, DC.

All comments will be available for public inspection and copying.

SECTION 8. EFFECTIVE DATE

This revenue procedure is effective for taxable years ending on or after July 30, 2015.

SECTION 9. DRAFTING INFORMATION

The principal author of this revenue procedure is David M. Christensen of the Office of Associate Chief Counsel (Income Tax & Accounting). For further information regarding this revenue procedure contact David M. Christensen on (202) 317-7011 (not a toll free call).