Internal Revenue
bulletin

Bulletin No. 2002–13
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HIGHLIGHTS OF THIS ISSUE

These synopses are intended only as aids to the reader in identifying the subject matter covered. They may not be relied upon as authoritative interpretations.

SPECIAL ANNOUNCEMENT

Announcement 2002–37, page 703.
Methods of accounting. This announcement discusses some of the most significant and prevalent issues raised in comments received in connection with Notice 98–31 (1998–1 C.B. 1165), which proposed procedures for Service-imposed accounting method changes and the resolution of accounting method issues on a nonaccounting-method-change basis.

INCOME TAX

Rev. Rul. 2002–15, page 668.
Fringe benefits aircraft valuation formula. The Standard Industry Fare Level (SIFL) cents-per-mile rates and terminal charges in effect for the first half of 2002 are set forth for purposes of determining the value of noncommercial flights on employer-provided aircraft under section 1.61–21(g) of the regulations.

T.D. 8984, page 668.
REG–102740–02, page 701.
Temporary, final, and proposed regulations under sections 337(d) and 1502 of the Code permit certain losses recognized on sales of subsidiary stock by members of a consolidated group. The regulations apply to corporations filing consolidated returns, both during and after the period of affiliation, and also affect purchasers of the stock of members of a consolidated group. A public hearing on the proposed regulations is scheduled for July 17, 2002.

Announcement 2002–34, page 702.
Extension of time to file Forms 1042-S. The Service announces an extension of time to file 2001 Form(s) 1042-S from March 15, 2002, to May 15, 2002.

Finding Lists begin on page ii.
Index for January through March begins on page v.

Department of the Treasury
Internal Revenue Service

EMPLOYEE PLANS

Announcement 2002–36, page 703.
Employee plans determinations letters; future of program. The Service extends the time, as stated in Announcement 2001–83 (2001–35 I.R.B. 205), for the submission of public comments on the future of the EP determination letter program from March 31, 2002, to July 1, 2002.

ADMINISTRATIVE

Rev. Proc. 2002–17, page 676.
Inventories; replacement cost; automobile dealers. A safe harbor method of accounting (the "replacement cost method") is provided for automobile dealers to approximate the cost of their vehicle parts inventory using the replacement cost of the parts. Procedures are also provided for automobile dealers to obtain the automatic consent of the Commissioner to change to the replacement cost method. Rev. Proc. 2002–9 modified and amplified.

Rev. Proc. 2002–18, page 678.
Changes in method of accounting; examinations. Procedures are provided under section 446 of the Code for changes in method of accounting imposed by the Service. Procedures are also provided for resolving accounting method issues on a nonaccounting-method basis.

Rev. Proc. 2002–19, page 696.
Changes in method of accounting; prior consent; automatic consent. Rev. Procs. 97–27 and 2002–9 are modified to (1) allow certain taxpayers under examination or before appeals or a federal court to change their method of accounting prospectively without audit protection, (2) reduce from 4 years to 1 year the adjustment period for prospective changes resulting in a net negative adjustment under section 481(a) of the Code, and (3) make certain other conforming changes. Rev. Procs. 97–27 and 2002–9 modified and amplified.

The IRS Mission

Provide America's taxpayers top quality service by helping them understand and meet their tax responsibilities and by applying the tax law with integrity and fairness to all.

Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest. It is published weekly and may be obtained from the Superintendent of Documents on a subscription basis. Bulletin contents are consolidated semiannually into Cumulative Bulletins, which are sold on a single-copy basis.

It is the policy of the Service to publish in the Bulletin all substantive rulings necessary to promote a uniform application of the tax laws, including all rulings that supersede, revoke, modify, or amend any of those previously published in the Bulletin. All published rulings apply retroactively unless otherwise indicated. Procedures relating solely to matters of internal management are not published; however, statements of internal practices and procedures that affect the rights and duties of taxpayers are published.

Revenue rulings represent the conclusions of the Service on the application of the law to the pivotal facts stated in the revenue ruling. In those based on positions taken in rulings to taxpayers or technical advice to Service field offices, identifying details and information of a confidential nature are deleted to prevent unwarranted invasions of privacy and to comply with statutory requirements.

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations, court decisions, rulings, and procedures must be considered, and Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The Bulletin is divided into four parts as follows:

Part I.—1986 Code.

This part includes rulings and decisions based on provisions of the Internal Revenue Code of 1986.

Part II.—Treaties and Tax Legislation.

This part is divided into two subparts as follows: Subpart A, Tax Conventions and Other Related Items, and Subpart B, Legislation and Related Committee Reports.

Part III.—Administrative, Procedural, and Miscellaneous.

To the extent practicable, pertinent cross references to these subjects are contained in the other Parts and Subparts. Also included in this part are Bank Secrecy Act Administrative Rulings. Bank Secrecy Act Administrative Rulings are issued by the Department of the Treasury's Office of the Assistant Secretary (Enforcement).

Part IV.—Items of General Interest.

This part includes notices of proposed rulemakings, disbarment and suspension lists, and announcements.

The first Bulletin for each month includes a cumulative index for the matters published during the preceding months. These monthly indexes are cumulated on a semiannual basis, and are published in the first Bulletin of the succeeding semiannual period, respectively.

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Part I. Rulings and Decisions Under the Internal Revenue Code of 1986

Section 61.—Gross Income Defined

26 CFR 1.61–21: Taxation of fringe benefits.

Rev. Rul. 2002–15

Fringe benefits aircraft valuation formula. For purposes of section 1.61–21(g) of the Income Tax Regulations, relating to the rule for valuing noncommercial flights on employer-provided aircraft, the Standard Industry Fare Level (SIFL) cents-per-mile rates and terminal charge in effect for the first half of 2002 are set forth.

For purposes of the taxation of fringe benefits under section 61 of the Internal Revenue Code, section 1.61–21(g) of the Income Tax Regulations provides a rule for valuing noncommercial flights on employer-provided aircraft. Section 1.61–21(g)(5) provides an aircraft valuation formula to determine the value of such flights. The value of a flight is determined under the base aircraft valuation formula (also known as the Standard Industry Fare Level formula or SIFL) by multiplying the SIFL cents-per-mile rates applicable for the period during which the flight was taken by the appropriate aircraft multiple provided in section 1.61–21(g)(7) and then adding the applicable terminal charge. The SIFL cents-per-mile rates in the formula and the terminal charge are calculated by the Department of Transportation and are reviewed semi-annually.

The following chart sets forth the terminal charges and SIFL mileage rates:

Period During Which the Flight Is Taken	*Terminal Charge*	*SIFL Mileage Rates*
1/1/02 — 6/30/02	$37.12	Up to 500 miles = $.2031 per mile 501–1500 miles = $.1548 per mile Over 1500 miles = $.1489 per mile

DRAFTING INFORMATION

The principal author of this revenue ruling is Kathleen Edmondson of the Office of Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). For further information regarding this revenue ruling, contact Ms. Edmondson at (202) 622–6040 (not a toll-free call).

Section 337.—Nonrecognition for Property Distributed to Parent in Complete Liquidation of Subsidiary

26 CFR 1.337(d)–2: Loss limitation window period.

T.D. 8984

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Parts 1 and 602

Loss Limitation Rules

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final and temporary regulations.

SUMMARY: This document contains regulations under sections 337(d) and 1502. These regulations permit certain losses recognized on sales of subsidiary stock by members of a consolidated group. These regulations apply to corporations filing consolidated returns, both during and after the period of affiliation, and also affect purchasers of the stock of members of a consolidated group. The text of these temporary regulations also serves as the text of the proposed regulations set forth in the notice of proposed rulemaking on this subject on page 701 of this issue of the Bulletin.

DATES: *Effective Date*: These regulations are effective March 7, 2002.

Applicability Date: For dates of applicability, see §§ 1.337(d)–2T(g), 1.1502–20T(i) and 1.1502–32T(b)(4)(v).

FOR FURTHER INFORMATION CONTACT: Sean P. Duffley (202) 622–7530 or Lola L. Johnson (202) 622–7550 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

These regulations are being issued without prior notice and public procedure pursuant to the Administrative Procedure Act (5 U.S.C. 553). For this reason, the collection of information contained in these regulations has been reviewed and, pending receipt and evaluation of public comments, approved by the Office of Management and Budget under control number 1545–1774. Responses to this collection of information are voluntary.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number assigned by the Office of Management and Budget.

For further information concerning this collection of information, and where to submit comments on the collection of

information and the accuracy of the estimated burden, and suggestions for reducing this burden, please refer to the preamble to the cross-referencing notice of proposed rulemaking (REG–102740–02) on page 701 of this Bulletin.

Books or records relating to the collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Background

Section 337(d) of the Internal Revenue Code, enacted in 1986, directs the Secretary to prescribe regulations to ensure that the purposes of *General Utilities* repeal, which generally requires a corporation to recognize gain or loss on a disposition of any asset, may not be circumvented through the use of the consolidated return regulations. Pursuant to that directive, in 1990, the IRS and Treasury promulgated § 1.337(d)–2. Section 1.337(d)–2 generally disallows any loss recognized by a member of a consolidated group on the disposition of subsidiary stock, except to the extent the consolidated group disposes of its entire equity interest in a subsidiary to persons not related to any member of the consolidated group within the meaning of section 267(b) or section 707(b)(1) (applying the language "10 percent" instead of "50 percent") and can establish that such loss is not attributable to the recognition of built-in gain. Section 1.337(d)–2, however, only applies with respect to dispositions and deconsolidations that occur on or after November 19, 1990, and that are not subject to § 1.1502–20.

Section 1.1502–20, which applies to all dispositions and deconsolidations of subsidiary stock that occur on or after February 1, 1991, disallows certain losses recognized by a member of a consolidated group on the disposition of subsidiary stock. The rule disallows losses to the extent of the sum of "extraordinary gain dispositions," "positive investment adjustments," and "duplicated loss." The rule is designed not only to implement *General Utilities* repeal, but also to further single entity principles by preventing the allowance of stock losses that are reflected in a subsidiary's assets or loss carryovers.

In *Rite Aid Corp. v. United States*, 255 F.3d 1357 (Fed. Cir. 2001), the United States Court of Appeals for the Federal Circuit held that the duplicated loss component of § 1.1502–20 was an invalid exercise of regulatory authority. As stated in Notice 2002–11 (2002–7 I.R.B. 526), the IRS has decided that the interests of sound tax administration will not be served by continuing to litigate the validity of the loss duplication factor of § 1.1502–20. Moreover, because of the interrelationship in the operation of all of the loss disallowance factors, the IRS and Treasury have decided that new rules governing loss disallowance on sales of stock of a member of a consolidated group should be implemented.

Explanation of Provisions

This Treasury decision adds §§ 1.337(d)–2T, 1.1502–20T(i), and 1.1502–32T(b)(4)(v), as described below.

For dispositions and deconsolidations of subsidiary stock on or after March 7, 2002, unless the disposition or deconsolidation was effected pursuant to a binding written contract entered into before such date that was in continuous effect until the disposition or deconsolidation, this Treasury decision provides that § 1.337(d)–2T, and not § 1.1502–20, governs the amount of loss allowable on such sales, or the amount of basis reduction required on such deconsolidations, of subsidiary stock. In substantial part, § 1.337(d)–2T restates the current § 1.337(d)–2, with certain modifications. As described above, as currently in effect, § 1.337(d)–2 permits recognition of loss only where a consolidated group disposes of its entire equity interest in a member of the group to persons not related to any member of the consolidated group within the meaning of section 267(b) or section 707(b)(1) (applying the language "10 percent" instead of "50 percent"). Section 1.337(d)–2T eliminates those restrictions.

For dispositions and deconsolidations of subsidiary stock before March 7, 2002, and dispositions and deconsolidations of subsidiary stock on or after March 7, 2002, that were effected pursuant to a binding written contract entered into before such date that was in continuous effect until the disposition or deconsolidation, this Treasury decision adds § 1.1502–20T(i). Section 1.1502–20T(i) permits consolidated groups to calculate allowable loss on the sale of subsidiary stock by applying § 1.1502–20 in its entirety or, in lieu thereof, by electing to apply one of two alternative regimes. In particular, the group may elect to apply the provisions of § 1.1502–20 without regard to the duplicated loss factor of the loss disallowance formula, *i.e.*, calculating disallowed loss by taking into account only extraordinary gain dispositions and positive investment adjustment amounts. Alternatively, the group may elect to apply the provisions of § 1.337(d)–2T. Such election may be made with the original return for the taxable year that includes the later of March 7, 2002, and the date of the disposition or deconsolidation of the stock of the subsidiary. Alternatively, the election may be made with an amended return, provided that the amended return is filed before the date the original return for the taxable year that includes March 7, 2002, is due.

An election described in § 1.1502–20(g) to reattribute losses will be respected only if the requirements of § 1.1502–20(g), including the requirement that the election be filed with the group's income tax return for the year of the disposition, have been or are satisfied. The temporary regulations do not extend the time for filing an election under § 1.1502–20(g). If a group made an election described in § 1.1502–20(g) and elects to determine allowable loss by applying one of the alternative regimes pursuant to § 1.1502–20T(i), the amount of loss treated as reattributed may be reduced. If the group elects to determine allowable loss by applying the provisions of § 1.1502–20 without regard to the duplicated loss factor of the loss disallowance formula, the amount of loss treated as reattributed is equal to the amount of loss originally reattributed, reduced to the extent that it exceeds the greater of (1) the loss disallowance amount determined by taking into account only extraordinary gain dispositions and positive investment adjustments (and not the duplicated loss factor of the loss disallowance formula) and (2) the amount of reattributed losses that the common parent of the selling group absorbed in closed years. If the

group elects to determine allowable loss by applying § 1.337(d)–2T, the amount of loss treated as reattributed is the greater of (1) zero and (2) the amount of reattributed losses that the common parent of the selling group absorbed in closed years. For this purpose, a taxable year is a closed year to the extent the assessment of a deficiency is prevented by any law or rule of law as of the date the election to apply one of the alternative regimes is filed and at all times thereafter.

To the extent that an election under § 1.1502–20T(i) results in a reduction in the amount of losses treated as reattributed, such excess losses will be treated as available for use by the subsidiary or any other group of which the subsidiary is a member, subject to any applicable limitations (*e.g.*, section 382). In order to permit the subsidiary's use of such losses that are subject to an existing section 382 limitation, § 1.1502–20T(i) allows the common parent of the group that disposed of the stock to make certain adjustments to the amount of such a limitation apportioned under § 1.1502–95 or § 1.1502–96.

Section 1.1502–20T(i) requires the common parent of the selling group to notify the subsidiary of the recomputed reattribution amount and any adjustment to the apportionment of a section 382 limitation made in connection with the election to apply one of the alternative regimes. In addition, if the acquirer was a member of a consolidated group at the time of the acquisition, the common parent of the selling group must provide such notification to the common parent of the acquirer at the time of the acquisition. The rules set forth in § 1.1502–20T(i) also confirm that any losses treated as reattributed to the common parent of the selling group will not be available to offset income of the subsidiary or any other group of which such subsidiary is a member.

The IRS and Treasury do not intend for a purchasing consolidated group to be unfairly disadvantaged in the event that the common parent of a selling member elects to apply one of the alternative regimes under § 1.1502–20T(i) and, as a result, the amount of losses treated as reattributed to the common parent of the selling group is decreased and the amount of losses treated as available to the subsidiary is increased. Therefore, this Treasury decision adds § 1.1502–32T(b)(4)(v), which provides that, to the extent that the subsidiary's loss carryovers are increased by reason of an election to apply one of the alternative regimes and such loss carryovers expire, or would have been properly used to offset income, in a closed year, the purchasing group will be deemed to have made an election to treat all of such expired loss carryovers as expiring for all Federal income tax purposes immediately before the subsidiary became a member of the purchasing group. Accordingly, no basis reduction under § 1.1502–32 will result from the expiration of, or failure to use, such losses.

Section 1.1502–32T(b)(4)(v) further provides that, to the extent the subsidiary's loss carryovers are increased by reason of an election to apply one of the alternative regimes and such loss carryovers have not expired, and would not have been properly used to offset income, in a closed year, the purchasing group may make an election under § 1.1502–32(b)(4) to treat all or a portion of such loss carryovers as expiring for all Federal income tax purposes immediately before the subsidiary became a member of the purchasing group. The election must be filed with the purchasing group's return for the taxable year in which the subsidiary receives the notification of the recomputed reattributed loss amount.

For purposes of § 1.1502–32T(b)(4)(v), a taxable year is a closed year to the extent the refund of an overpayment is prevented by any law or rule of law as of the date the group files its original return for the taxable year in which the subsidiary receives the notification of the recomputed reattributed loss amount and at all times thereafter.

Special Analyses

In light of the Federal Circuit's decision in *Rite Aid Corp. v. United States*, 255 F.3d 1357 (Fed. Cir. 2001), these temporary regulations are necessary in order to provide taxpayers with immediate guidance regarding allowable loss and basis reductions in connection with dispositions and deconsolidations of subsidiary stock and to carry out the principles of *General Utilities* repeal pending the issuance of further guidance. These temporary regulations permit taxpayers to determine the amount of allowable loss or basis reduction by applying § 1.1502–20 in its entirety or, in lieu thereof, by electing to apply the provisions of either § 1.337(d)–2T or 1.1502–20 without regard to § 1.1502–20(c)(1)(iii). In addition, these temporary regulations provide taxpayers with guidance on the effect of elections previously made under § 1.1502–20(g) to reattribute losses to the common parent of a selling group. Accordingly, good cause is found for dispensing with notice and public procedure pursuant to 5 U.S.C. 553(b)(B) and with a delayed effective date pursuant to 5 U.S.C. 553(d)(1) and (3).

Because no notice of proposed rulemaking is required, the provisions of the Regulatory Flexibility Act (5 U.S.C. 601 *et seq.*) do not apply.

Drafting Information

The principal authors of these regulations are Sean P. Duffley and Lola L. Johnson, Office of Associate Chief Counsel (Corporate). However, other personnel from the IRS and Treasury Department participated in their development.

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Amendments to the Regulations

Accordingly, 26 CFR parts 1 and 602 are amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by adding entries in numerical order to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Section 1.337(d)–2T also issued under 26 U.S.C. 337(d). * * *

Section 1.1502–20T(i) also issued under 26 U.S.C. 1502. * * *

Section 1.1502–32T(b)(4)(v) also issued under 26 U.S.C. 1502. * * *

Par. 2. Section 1.337(d)–2 is amended by adding paragraph (g)(4) to read as follows:

§ 1.337(d)–2 Loss limitation window period.

* * * * *

(g) * * *

(4) For dispositions and deconsolidations on and after March 7, 2002, see § 1.337(d)–2T.

Par. 3. Section 1.337(d)–2T is added to read as follows:

§ 1.337(d)–2T Loss limitation window period (temporary).

(a) *Loss disallowance*—(1) *General rule*. No deduction is allowed for any loss recognized by a member of a consolidated group with respect to the disposition of stock of a subsidiary.

(2) *Definitions*. For purposes of this section:

(i) The definitions in § 1.1502–1 apply.

(ii) *Disposition* means any event in which gain or loss is recognized, in whole or in part.

(3) *Coordination with loss deferral and other disallowance rules*. For purposes of this section, the rules of § 1.1502–20(a)(3) apply, with appropriate adjustments to reflect differences between the approach of this section and that of § 1.1502–20.

(b) *Basis reduction on deconsolidation*—(1) *General rule*. If the basis of a member of a consolidated group in a share of stock of a subsidiary exceeds its value immediately before a deconsolidation of the share, the basis of the share is reduced at that time to an amount equal to its value. If both a disposition and a deconsolidation occur with respect to a share in the same transaction, paragraph (a) of this section applies and, to the extent necessary to effectuate the purposes of this section, this paragraph (b) applies following the application of paragraph (a) of this section.

(2) *Deconsolidation*. *Deconsolidation* means any event that causes a share of stock of a subsidiary that remains outstanding to be no longer owned by a member of any consolidated group of which the subsidiary is also a member.

(3) *Value*. *Value* means fair market value.

(c) *Allowable Loss*—(1) *Application*. This paragraph (c) applies with respect to stock of a subsidiary only if a separate statement entitled "§ 1.337(d)–2T(c) statement" is included with the return in accordance with paragraph (c)(3) of this section.

(2) *General rule*. Loss is not disallowed under paragraph (a)(1) of this section and basis is not reduced under paragraph (b)(1) of this section to the extent the taxpayer establishes that the loss or basis is not attributable to the recognition of built-in gain on the disposition of an asset (including stock and securities). Loss or basis may be attributable to the recognition of built-in gain on the disposition of an asset by a prior group. For purposes of this section, gain recognized on the disposition of an asset is built-in gain to the extent attributable, directly or indirectly, in whole or in part, to any excess of value over basis that is reflected, before the disposition of the asset, in the basis of the share, directly or indirectly, in whole or in part, after applying section 1503(e) and other applicable provisions of the Internal Revenue Code and regulations.

(3) *Contents of statement and time of filing*. The statement required under paragraph (c)(1) of this section must be included with or as part of the taxpayer's return for the year of the disposition or deconsolidation and must contain:

(i) The name and employer identification number (E.I.N.) of the subsidiary.

(ii) The amount of the loss not disallowed under paragraph (a)(1) of this section by reason of this paragraph (c) and the amount of basis not reduced under paragraph (b)(1) of this section by reason of this paragraph (c).

(4) *Example*. The principles of paragraphs (a), (b), and (c) of this section are illustrated by the examples in §§ 1.337(d)–1(a)(5) and 1.1502–20(a)(5) (other than *Examples 3*, *4*, and *5*) and (b), with appropriate adjustments to reflect differences between the approach of this section and that of § 1.1502–20, and by the following example. For purposes of the examples in this section, unless otherwise stated, the group files consolidated returns on a calendar year basis, the facts set forth the only corporate activity, and all sales and purchases are with unrelated buyers or sellers. The basis of each asset is the same for determining earnings and profits adjustments and taxable income. Tax liability and its effect on basis, value, and earnings and profits are disregarded. *Investment adjustment system* means the rules of § 1.1502–32.

Example. Loss offsetting built-in gain in a prior group. (i) P buys all the stock of T for $50 in Year 1, and T becomes a member of the P group. T has 2 assets. Asset 1 has a basis of $50 and a value of $0, and asset 2 has a basis of $0 and a value of $50. T sells asset 2 during Year 3 for $50, and recognizes a $50 gain. Under the investment adjustment system, P's basis in the T stock increased to $100 as a result of the recognition of gain. In Year 5, all of the stock of P is acquired by the P1 group, and the former members of the P group become members of the P1 group. T then sells asset 1 for $0, and recognizes a $50 loss. Under the investment adjustment system, P's basis in the T stock decreases to $50 as a result of the loss. T's assets decline in value from $50 to $40. P then sells all the stock of T for $40 and recognizes a $10 loss.

(ii) P's basis in the T stock reflects both T's unrecognized gain and unrecognized loss with respect to its assets. The gain T recognizes on the disposition of asset 2 is built-in gain with respect to both the P and the P1 groups for purposes of paragraph (c)(2) of this section. In addition, the loss T recognizes on the disposition of asset 2 is built-in loss with respect to the P and P1 groups for purposes of paragraph (c)(2) of this section. T's recognition of the built-in loss while a member of the P1 group offsets the effect on T's stock basis of T's recognition of the built-in gain while a member of the P group. Thus, P's $10 loss on the sale of the T stock is not attributable to the recognition of built-in gain, and the loss is therefore not disallowed under paragraph (c)(2) of this section.

(iii) The result would be the same if, instead of having a $50 built-in loss in asset 2 when it becomes a member of the P group, T has a $50 net operating loss carryover and the carryover is used by the P group.

(d) *Successors*. For purposes of this section, the rules and examples of § 1.1502–20(d) apply, with appropriate adjustments to reflect differences between the approach of this section and that of § 1.1502–20.

(e) *Anti-avoidance rules*. For purposes of this section, the rules and examples of § 1.1502–20(e) apply, with appropriate adjustments to reflect differences between the approach of this section and that of § 1.1502–20.

(f) *Investment adjustments*. For purposes of this section, the rules and examples of § 1.1502–20(f) apply, with appropriate adjustments to reflect differences between the approach of this section and that of § 1.1502–20.

(g) *Effective dates*. This section applies with respect to dispositions and deconsolidations on or after March 7, 2002, unless the disposition or deconsolidation was effected pursuant to a binding written contract entered into before March 7, 2002, that was in continuous effect until the disposition or deconsolidation. In addition, this section applies to dispositions and deconsolidations for which an election is made under § 1.1502–20T(i)(2) to determine allowable loss under this section. If loss is recognized because stock of a subsidiary became worthless, the disposition with respect to

the stock is treated as occurring on the date the stock became worthless. For dispositions and deconsolidations prior to March 7, 2002, see §§ 1.337(d)–1 and 1.337(d)–2 as contained in the 26 CFR part 1 edition revised as of April 1, 2001.

Par. 4. In § 1.1502–20, paragraph (i) is added to read as follows:

§ 1.1502–20 Disposition or deconsolidation of subsidiary stock.

* * * * *

(i) [Reserved]. For further guidance, see § 1.1502–20T(i).

Par. 5. Section 1.1502–20T is added to read as follows:

§ 1.1502–20T Disposition or deconsolidation of subsidiary stock (temporary).

(a) through (h) [Reserved]. For further guidance, see § 1.1502–20(a) through (h).

(i) *Limitations on the applicability of § 1.1502–20*—(1) *Dispositions and deconsolidations on or after March 7, 2002*. Except to the extent specifically incorporated in § 1.337(d)–2T, § 1.1502–20 does not apply to a disposition or deconsolidation of stock of a subsidiary on or after March 7, 2002, unless the disposition or deconsolidation was effected pursuant to a binding written contract entered into before March 7, 2002, that was in continuous effect until the disposition or deconsolidation.

(2) *Dispositions and deconsolidations prior to March 7, 2002*. In the case of a disposition or deconsolidation of stock of a subsidiary by a member before March 7, 2002, or a disposition or deconsolidation on or after March 7, 2002, that was effected pursuant to a binding written contract entered into before March 7, 2002, that was in continuous effect until the disposition or deconsolidation, a consolidated group may determine the amount of the member's allowable loss or basis reduction by applying § 1.1502–20 in its entirety, or, in lieu thereof, subject to the conditions set forth in this paragraph (i), by making an irrevocable election to apply the provisions of either—

(i) Section 1.1502–20, except that in applying § 1.1502–20(c)(1), the amount of loss disallowed under § 1.1502–20(a)(1) and the amount of basis reduction under § 1.1502–20(b)(1) with respect to a share of stock will not exceed the sum of the amounts described in § 1.1502–20(c)(1)(i) and (ii); or

(ii) Section 1.337(d)–2T.

(3) *Operating rules*—(i) *Reattribution of losses in the case of an election to determine allowable loss by applying the provisions described in paragraph (i)(2)(i) of this section*. If a consolidated group elects to determine allowable loss by applying the provisions described in paragraph (i)(2)(i) of this section, an election described in § 1.1502–20(g) to reattribute losses will be respected only if the requirements of § 1.1502–20(g), including the requirement that the election be filed with the group's income tax return for the year of the disposition, have been or are satisfied. For example, if a consolidated group did not file a valid election described in § 1.1502–20(g) with its return for the year of the disposition, this section does not authorize the group that disposed of the stock to make such an election with its return for the year in which it elects to determine its allowable stock loss under the provisions described in paragraph (i)(2)(i) of this section. If a consolidated group that made a valid election described in § 1.1502–20(g) with respect to the disposition of stock elects to determine allowable loss by applying the provisions described in paragraph (i)(2)(i) of this section, the election described in § 1.1502–20(g) may not be revoked, and the amount of loss treated as reattributed as of the time of the disposition pursuant to the election described in § 1.1502–20(g) is the amount of loss originally reattributed, reduced to the extent that it exceeds the greater of—

(A) The amount of stock loss disallowed after applying the provisions described in paragraph (i)(2)(i) of this section; and

(B) The amount of reattributed losses that the group that disposed of the stock absorbed in years for which the assessment of a deficiency is prevented by any law or rule of law as of the date the election to apply the provisions described in paragraph (i)(2)(i) of this section is filed and at all times thereafter.

(ii) *Reattribution of losses in the case of an election to determine allowable loss by applying the provisions described in paragraph (i)(2)(ii) of this section*. If a consolidated group elects to determine allowable loss by applying the provisions described in paragraph (i)(2)(ii) of this section, the consolidated group may not make an election described in § 1.1502–20(g) to reattribute any losses. If the consolidated group made an election described in §1.1502–20(g) with respect to the disposition of subsidiary stock, the amount of loss treated as reattributed pursuant to such election will be the greater of—

(A) Zero; and

(B) The amount of reattributed losses that the group that disposed of the stock absorbed in years for which the assessment of a deficiency is prevented by any law or rule of law as of the date the election to apply the provisions described in paragraph (i)(2)(ii) of this section is filed and at all times thereafter.

(iii) *Apportionment of section 382 limitation in the case of a reduction of reattributed losses*—(A) *Losses subject to a separate section 382 limitation*. If, as a result of the application of paragraph (i)(3)(i) or (ii) and paragraph (i)(3)(vii) of this section, pre-change separate attributes that were subject to a separate section 382 limitation are treated as losses of a subsidiary and the common parent previously elected to apportion all or a part of such limitation to itself under § 1.1502–96(d), the common parent may reduce the amount of such limitation apportioned to itself.

(B) *Losses subject to a subgroup section 382 limitation*. If, as a result of the application of paragraph (i)(3)(i) or (ii) and paragraph (i)(3)(vii) of this section, pre-change subgroup attributes that were subject to a subgroup section 382 limitation are treated as losses of a subsidiary and the common parent previously elected to apportion all or a part of such limitation to itself under § 1.1502–96(d), the common parent may reduce the amount of such limitation apportioned to itself. In addition, if such subsidiary has ceased to be a member of the loss subgroup to which the pre-change subgroup attributes relate, the common parent may increase the total amount of such limitation apportioned to such subsidiary (or loss subgroup that includes such subsidiary) under § 1.1502–95(c) by an amount not in excess of the amount by which such limitation that is apportioned to the common parent is reduced pursuant to the previous sentence.

(C) *Losses subject to a consolidated section 382 limitation*. If, as a result of the application of paragraph (i)(3)(i) or (ii) and paragraph (i)(3)(vii) of this section, pre-change consolidated attributes (or pre-change subgroup attributes) that were subject to a consolidated section 382 limitation (or subgroup section 382 limitation where the common parent was a member of the loss subgroup) are treated as losses of a subsidiary, and the subsidiary has ceased to be a member of the loss group (or loss subgroup), the common parent may increase the amount of such limitation that is apportioned to such subsidiary (or loss subgroup that includes such subsidiary) under § 1.1502–95(c). The amount of each element of such limitation that can be apportioned to a subsidiary (or loss subgroup that includes such subsidiary) pursuant to this paragraph (i)(3)(iii)(C), however, cannot exceed the product of (x) the element and (y) a fraction the numerator of which is the amount of pre-change consolidated attributes (or subgroup attributes) subject to that limitation that are treated as losses of the subsidiary (or loss subgroup) as a result of the application of paragraph (i)(3)(i) or (ii) and paragraph (i)(3)(vii) of this section and the denominator of which is the total amount of pre-change attributes subject to that limitation determined as of the close of the taxable year in which the subsidiary ceases to be a member of the group (or loss subgroup).

(D) *Operating rules*—(*i*) *Limitations on apportionment*. In making any adjustment to an apportionment of a subgroup section 382 limitation or a consolidated section 382 limitation pursuant to paragraph (i)(3)(iii)(B) or (C) of this section, the common parent must take into account the extent, if any, to which such limitation has previously been apportioned to another subsidiary or loss subgroup prior to the date the election to apply the provisions described in paragraph (i)(2)(i) or (ii) of this section is filed.

(*ii*) *Manner and effect of adjustment to previous apportionment of limitation to common parent*. Any reduction in a previous apportionment of a separate section 382 limitation or a subgroup section 382 limitation to the common parent made pursuant to paragraph (i)(3)(iii)(A) or (B) of this section is treated as effective when the previous apportionment was effective. Any such adjustment must be made in a manner consistent with the principles of § 1.1502–95(c). For example, to the extent the apportionment of a separate section 382 limitation or a subgroup section 382 limitation to a common parent is reduced pursuant to paragraph (i)(3)(iii)(A) or (B) of this section, the amount of such limitation available to the subsidiary or loss subgroup, as applicable, is increased.

(*iii*) *Manner and effect of adjustment to apportionment of limitation to departing subsidiary or loss subgroup*. Any increase in an amount of a subgroup section 382 limitation or a consolidated section 382 limitation apportioned to a departing subsidiary (or loss subgroup that includes such subsidiary) made pursuant to paragraph (i)(3)(iii)(B) or (C) of this section is treated as effective for taxable years ending after the date the subsidiary ceases to be a member of the group or loss subgroup. Any such adjustment may be made regardless of whether the common parent previously elected to apportion all or a part of such limitation to such subsidiary (or loss subgroup that includes such subsidiary) under § 1.1502–95(c) or 1.1502–95A(c), but must be made in a manner consistent with the principles of § 1.1502–95(c). For example, to the extent the apportionment of an element of a subgroup section 382 limitation or a consolidated section 382 limitation to a departing subsidiary is increased pursuant to paragraph (i)(3)(iii)(B) or (C) of this section, the amount of such element of such limitation that is available to the loss subgroup or loss group is reduced consistent with § 1.1502–95(c)(3).

(*iv*) *Prohibition against other adjustments*. This paragraph (i)(3)(iii) does not authorize the common parent to adjust the apportionment of any separate section 382 limitation, subgroup section 382 limitation, or consolidated section 382 limitation that it previously apportioned to a subsidiary, to a loss subgroup, or to itself under § 1.1502–95(c), 1.1502–95A(c), or 1.1502–96(d), other than as provided in paragraphs (i)(3)(iii)(A), (B), and (C) of this section.

(E) *Time and manner of making apportionment adjustment*. An adjustment to the apportionment of any separate section 382 limitation, subgroup section 382 limitation, or consolidated section 382 limitation pursuant to paragraph (i)(3)(iii)(A), (B), or (C) of this section must be made as part of the group's election to apply the provisions of paragraph (i)(2)(i) or (ii) of this section, as described in paragraph (i)(4) of this section.

(iv) *Notification of reduction of reattributed losses and adjustment of apportionment of section 382 limitation*. If the application of paragraph (i)(3)(i) or (ii) of this section results in a reduction of the losses treated as reattributed pursuant to an election described in § 1.1502–20(g), then, prior to the date that the group files its income tax return for the taxable year that includes March 7, 2002, the common parent must send the notification required by this paragraph to the subsidiary, at the subsidiary's last known address. In addition, if the acquirer of the subsidiary stock was a member of a consolidated group at the time of the disposition, the common parent must send a copy of such notification to the person that was the common parent of the acquirer's group at the time of the acquisition, at its last known address. The notification is to be in the form of a statement entitled "Recomputation of Losses Reattributed Pursuant to the Election Described in § 1.1502–20(g)," that is signed by the common parent and that includes the following information—

(A) The name and employer identification number (E.I.N.) of the subsidiary;

(B) The original and the recomputed amount of losses treated as reattributed pursuant to the election described in § 1.1502–20(g); and

(C) If the apportionment of a separate section 382 limitation, a subgroup section 382 limitation, or a consolidated section 382 limitation is adjusted pursuant to paragraph (i)(3)(iii)(A), (B), or (C) of this section, the original and the adjusted apportionment of such limitation.

(v) *Items taken into account in closed years*. An election under paragraph (i)(2) of this section affects a taxpayer's items of income, gain, deduction, or loss only to the extent that the election gives rise,

directly or indirectly, to items or amounts that would properly be taken into account in a year for which an assessment of deficiency or a refund of overpayment, as the case may be, is not prevented by any law or rule of law.

(vi) *Conforming amendments for items previously taken into account in open years*. To the extent that, on any Federal income tax return, the common parent absorbed losses that were reattributed pursuant to an election described in § 1.1502–20(g) and the amount of losses so absorbed is in excess of the amount of losses that are treated as reattributed after application of paragraph (i)(3)(i) or (ii) of this section, or that may be taken into account after any adjustment to an apportionment of a separate section 382 limitation, a subgroup section 382 limitation, or a consolidated section 382 limitation pursuant to paragraph (i)(3)(iii) of this section, such returns must be amended to the greatest extent possible to reflect the reduction in the amount of losses treated as reattributed and any adjustment to the apportionment of such limitation.

(vii) *Availability of losses to subsidiary*. To the extent that any losses of a subsidiary are reattributed to the common parent pursuant to an election described in § 1.1502–20(g), such reattribution is binding on the subsidiary and any group of which the subsidiary is or becomes a member. Therefore, if the subsidiary ceases to be a member of the group, any reattributed losses are not thereafter available to the subsidiary and may not be utilized by the subsidiary or any other group of which such subsidiary is or becomes a member. To the extent that the application of paragraph (i)(3)(i) or (ii) of this section results in a reduction in the amount of losses treated as reattributed to the common parent pursuant to an election described in § 1.1502–20(g), however, losses in the amount of such reduction are available to the subsidiary and may be utilized by the subsidiary or any group of which such subsidiary is a member, subject to applicable limitations (*e.g.*, section 382).

(4) *Time and manner of making the election*. An election to determine allowable loss or basis reduction by applying the provisions described in paragraph (i)(2)(i) or (ii) of this section is made by including the statement required by this paragraph with or as part of the original return for the taxable year that includes the later of March 7, 2002, and the date of the disposition or deconsolidation of the stock of the subsidiary, or with or as part of an amended return filed before the date the original return for the taxable year that includes March 7, 2002, is due. The statement shall be entitled "Allowed Loss under Section [Specify Section under Which Allowed Loss Is Determined] Pursuant to Section 1.1502–20T(i)" and must include the following information—

(i) The name and employer identification number (E.I.N.) of the subsidiary and of the member(s) that disposed of the subsidiary stock;

(ii) In the case of an election to determine allowable loss or basis reduction by applying the provisions described in paragraph (i)(2)(i) of this section, a statement that the taxpayer elects to determine allowable loss or basis reduction by applying such provisions;

(iii) In the case of an election to determine allowable loss or basis reduction by applying the provisions described in paragraph (i)(2)(ii) of this section, a statement that the taxpayer elects to determine allowable loss or basis reduction by applying such provisions;

(iv) If an election described in § 1.1502–20(g) was made with respect to the disposition of the stock of the subsidiary, the amount of losses originally treated as reattributed pursuant to such election and the amount of losses treated as reattributed pursuant to paragraph (i)(3)(i) or (ii) of this section;

(v) If an apportionment of a separate section 382 limitation, a subgroup section 382 limitation, or a consolidated section 382 limitation is adjusted pursuant to paragraph (i)(3)(iii)(A), (B), or (C) of this section, the original and redetermined apportionment of such limitation; and

(vi) If the application of paragraph (i)(3)(i) or (ii) of this section results in a reduction of the amount of losses treated as reattributed pursuant to an election described in § 1.1502–20(g), a statement that the notification described in paragraph (i)(3)(iv) of this section was sent to the subsidiary and, if the acquirer was a member of a consolidated group at the time of the stock sale, to the person that was the common parent of such group at such time, as required by paragraph (i)(3)(iv) of this section.

(5) *Cross references*. See § 1.1502–32(b)(4)(v) for a special rule for filing a waiver of loss carryovers.

Par. 6. Section 1.1502–32 is amended by adding paragraph (b)(4)(v) to read as follows:

§ 1.1502–32 Investment adjustments.

* * * * *

(b) * * *

(4) * * *

(v) [Reserved]. For further guidance, see § 1.1502–32T(b)(4)(v).

Par. 7. Section 1.1502–32T is added to read as follows:

§ 1.1502–32T Investment adjustments (temporary).

(a) through (b)(4)(iv) [Reserved]. For further guidance, see § 1.1502–32(a) through (b)(4)(iv).

(v) *Special rule for loss carryovers of a subsidiary acquired in a transaction for which an election under § 1.1502–20T(i)(2) is made*—(A) *Expired losses*. Notwithstanding § 1.1502–32(b)(4)(iv), to the extent that S's loss carryovers are increased by reason of an election under § 1.1502–20T(i)(2) and such loss carryovers expire or would have been properly used to offset income in a taxable year for which the refund of an overpayment is prevented by any law or rule of law as of the date the group files its original return for the taxable year in which S receives the notification described in § 1.1502–20T(i)(3)(iv) and at all times thereafter, the group will be deemed to have made an election under § 1.1502–32(b)(4) to treat all of such expired loss carryovers as expiring for all Federal income tax purposes immediately before S became a member of the consolidated group.

(B) *Available losses*. Notwithstanding § 1.1502–32(b)(4)(iv), to the extent that S's loss carryovers are increased by reason of an election under § 1.1502–20T(i)(2) and such loss carryovers have not expired and would not have been properly used to offset income in a taxable year for which the refund of an overpayment is prevented by any law or rule of law as of the date the group files its original return for the taxable year in which S receives the notification described in § 1.1502–20T(i)(3)(iv) and at all times thereafter, the group may

make an election under § 1.1502–32(b)(4) to treat all or a portion of such loss carryovers as expiring for all Federal income tax purposes immediately before S became a member of the consolidated group. Such election must be filed with the group's original return for the taxable year in which S receives the notification described in § 1.1502–20T(i)(3)(iv).

(C) *Effective date*. This paragraph (b)(4)(v) is applicable on and after March 7, 2002.

(c) through (h)(5)(ii) [Reserved]. For further guidance, see § 1.1502–32(c) through (h)(5)(ii).

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 8 The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 9. In § 602.101, paragraph (b) is amended by adding entries to the table in numerical order to read in part as follows:

§ 602.101 OMB Control numbers.

* * * * *

(b) * * *

CFR part or section where identified and described	Current OMB control No.
* * * * *	
1.337(d)–2T	1545–1774
* * * * *	
1.1502–20T	1545–1774
* * * * *	
1.1502–32T	1545–1774
* * * * *	

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

Approved February 27, 2002.

Mark Weinberger,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on March 7, 2002, 3:17 p.m., and published in the issue of the Federal Register for March 12, 2002, 67 F.R. 11034)

Section 446.—General Rule for Methods of Accounting.

26 CFR 1.446–1: General rule for methods of accounting.

A safe harbor method of accounting (the "replacement cost method") is provided for automobile dealers to approximate the cost of their vehicle parts inventory using the replacement cost of the parts. Procedures are also provided for automobile dealers to obtain the automatic consent of the Commissioner to change to the replacement cost method. See Rev. Proc. 2002–17, page 676.

Procedures are provided for Service-imposed accounting method changes and for accounting method issues resolved on a nonaccounting-method-change basis. See Rev. Proc. 2002–18, page 678.

Procedures are provided under which certain taxpayers under examination or before appeals or a federal court may obtain consent to change a method of accounting prospectively without audit protection. See Rev. Proc. 2002–19, page 696.

Section 471.—General Rule for Inventories

26 CFR 1.471–3: Inventories at cost.

A safe harbor method of accounting (the "replacement cost method") is provided for automobile dealers to approximate the cost of their vehicle parts inventory using the replacement cost of the parts. See Rev. Proc. 2002–17, page 676.

Section 481.—Adjustments Required by Changes in Method of Accounting

26 CFR 1.481–1: Adjustments in general.

Procedures are provided for automobile dealers to obtain the automatic consent of the Commissioner to use a safe harbor "replacement cost method" determining the cost of vehicle parts inventory. This change is made without a § 481 (a) adjustment. See Rev. Proc. 2002–17, page 676.

Procedures are provided for Service-imposed accounting method changes and for accounting method issues resolved on a nonaccounting-method-change basis. See Rev. Proc. 2002–18, page 678.

The period for taking into account a net negative adjustment under section 481(a) of the Code resulting from an accounting method change is reduced from 4 years to 1 year. Certain other conforming changes are made to Rev. Proc. 97–27 and Rev. Proc. 2002–9. See Rev. Proc. 2002–19, page 696.

Some of the most significant and prevalent comments received in connection with Notice 98–31, which proposed procedures for Service-imposed accounting method changes, and for resolving accounting method issues on a nonaccounting-method-change basis, are discussed. See Announcement 2002–37, page 703.

26 CFR 601.204: Changes in accounting periods and in methods of accounting.
(Also Part I, §§ 446, 471, 472, 481; 1.446–1, 1.471–3(d), 1.472–8, 1.481–1.)

Rev. Proc. 2002–17

SECTION 1. PURPOSE

This revenue procedure provides automobile dealers (as defined in section 3 of this revenue procedure) with a safe harbor method of accounting for their vehicle parts inventory. This safe harbor method permits automobile dealers to approximate the cost of their vehicle parts inventory using the replacement cost of the vehicle parts pursuant to the replacement cost method described in section 4 of this revenue procedure. This revenue procedure also provides procedures for automobile dealers to obtain the automatic consent of the Commissioner to change to the replacement cost method.

SECTION 2. BACKGROUND

.01 Section 471 of the Internal Revenue Code provides that inventories must be taken on such basis as the Secretary may prescribe as conforming as nearly as may be to the best accounting practice in the trade or business and as most clearly reflecting income.

.02 Section 1.471–3(d) of the Income Tax Regulations provides that in any industry in which the usual rules for computation of cost are inapplicable, cost may be approximated upon such basis as may be reasonable and in conformity with established trade practice in the particular industry.

.03 Section 472(a) provides that a taxpayer may use the last-in, first-out (LIFO) inventory method. Under the LIFO inventory method, a taxpayer treats those goods remaining on hand at the close of the taxable year as being: First, those included in the opening inventory of the taxable year (in the order of acquisition) to the extent thereof, and second, those acquired in the taxable year. The change to, and use of, the LIFO inventory method must be in accordance with such regulations as the Secretary may prescribe as necessary in order that the use of such method may clearly reflect income.

.04 Section 472(b)(2) provides that a taxpayer using the LIFO inventory method must inventory its goods at cost.

.05 Section 1.472–8(a) provides that a taxpayer may elect to determine the cost of its LIFO inventories under the dollar-value LIFO method, provided such method is used consistently and clearly reflects the income of the taxpayer in accordance with the rules of that section.

.05 Section 1.472–8(e)(2)(ii) provides that the total current-year cost of items making up a dollar-value LIFO pool may be determined: (a) by reference to the actual cost of the goods most recently purchased or produced; (b) by reference to the actual cost of the goods purchased or produced during the taxable year in the order of acquisition; (c) by application of an average unit cost equal to the aggregate cost of all the goods purchased or produced throughout the taxable year divided by the total number of units so purchased or produced; or (d) pursuant to any other proper method which, in the opinion of the Commissioner, clearly reflects income.

.06 Section 263A generally requires direct costs and an allocable portion of indirect costs of certain property produced or acquired for resale by a taxpayer to be included in inventory costs, in the case of property that is inventory, or to be capitalized, in the case of other property. Section 1.263A–1(e)(2)(ii) provides that resellers must capitalize the acquisition costs of property acquired for resale. In addition, resellers must capitalize the indirect costs described in §1.263A–1(e)(3), which are properly allocable to property acquired for resale. These indirect costs often include purchasing, handling, and storage costs. See § 1.263A–3(c)(1).

.07 In *Mountain State Ford v. Commissioner*, 112 T.C. 58 (1999), the Tax Court held that a taxpayer that sold heavy truck parts and used the dollar-value LIFO method to account for its parts inventory was not entitled to determine the current-year cost of the parts in its ending inventory by reference to their replacement cost. In so doing, the court found that the taxpayer's replacement cost method was not in accordance with the method elected on its Form 970, *Application to Use LIFO Inventory Method*. The taxpayer's Form 970 indicated that it would determine the current-year cost of the items in its ending inventory by reference to the actual cost of the goods most recently purchased or produced in accordance with § 1.472–8(e)(2)(ii)(a). The court further concluded that even if the taxpayer had elected to use another proper method under § 1.472–8(e)(2)(ii)(d), it could not use the replacement cost of the parts to determine current-year cost because replacement cost does not determine current-year cost on the basis of, or by reference to, actual cost (or in some instances a reasonable approximation of actual cost) in accordance with § 472(b).

.08 Subsequent to the *Mountain State Ford* decision, the Service has given careful consideration to the following unique circumstances surrounding the use of replacement cost by automobile dealers:

(1) *Industry practice*. It has been the long-standing and widespread practice of automobile dealers to use replacement cost to determine the cost of their vehicle parts inventory both for financial accounting and federal income tax purposes.

(2) *Use of replacement cost required by third party*. Automobile dealers are commonly required by their franchisors (*i.e.*, the vehicle's manufacturer) to value their vehicle parts inventory using replacement cost, rather than actual cost.

(3) *Substantial burden associated with switching to actual cost*. The automobile dealer industry has represented that automobile dealers that are presently using replacement cost to value their vehicle parts inventory likely would incur substantial expense if they were required to modify their existing recordkeeping systems to determine the cost of such inventory using actual cost.

(4) *Replacement cost approximates actual cost in this industry*. The automobile dealer industry has provided data to demonstrate that, on average, in their industry, due to relatively low inflation and high inventory turnover, the replacement cost of vehicle parts approximates the actual cost of such parts.

Consideration of these factors has led the Service to conclude that, for reasons of administrative convenience, burden reduction, and avoidance of further controversy in this area, a safe harbor method of accounting to determine the cost of vehicle parts inventory using replacement cost to approximate actual cost should be provided to automobile dealers. Accordingly, a safe harbor method is provided in section 4 of this revenue procedure and is available to automobile dealers that satisfy the requirements of this revenue procedure. The Service also is willing to consider requests of other industries for similar safe harbors if the facts of those industries are similar to those described above.

SECTION 3. SCOPE

This revenue procedure applies to any taxpayer that is engaged in the trade or business of selling vehicle parts at retail and that is authorized under an agreement with one or more vehicle manufacturers or distributors to sell new automobiles or new light, medium, or heavy-duty trucks ("automobile dealer").

SECTION 4. REPLACEMENT COST METHOD

.01 *In General*. A taxpayer that is within the scope of this revenue procedure is permitted to use the replacement cost method to approximate the actual cost of its vehicle parts inventory. Under the replacement cost method, a taxpayer must determine the cost of the vehicle parts in its inventory by reference to the replacement cost of the vehicle parts as defined in section 4.02 of this revenue procedure, determine the replacement cost using a standard price list as defined in section 4.03 of this revenue procedure, and satisfy the book conformity requirement as described in section 4.04 of this revenue procedure. Taxpayers within the scope of this revenue procedure may use the replacement cost method in conjunction with either the first-in, first-out inventory method or the LIFO inventory method. Taxpayers that use the replacement cost method provided by this section 4 and that are subject to the provisions of § 263A must include in inventory costs the additional amounts that are required by §§ 1.263A–1 and 1.263A–3 (*e.g.*, freight costs).

.02 *Replacement Cost*. Replacement cost means the amount provided in a standard price list at which a vehicle part may be purchased by the taxpayer on the date of the inventory. If, on the date of the inventory, the vehicle part is not provided in a standard price list, the replacement cost for the part is equal to the last amount provided in a standard price list (*i.e.*, the price at which the part was last offered for purchase in a standard price list).

.03 *Use of Standard Price List*. A "standard price list" is a price list that is widely recognized and used for business purposes in the automobile dealer industry and that is used by the taxpayer in the ordinary course of its business to purchase the vehicle parts for which it is determining the cost.

.04 *Book Conformity*. A taxpayer satisfies the book conformity requirement if it determines the cost of vehicle parts in its inventory using the replacement cost of the vehicle parts as defined in section 4.02 when it ascertains the income, profit, or loss of its trade or business for purposes of its books, records, and reports (including financial statements) to its shareholders, partners, other proprietors, beneficiaries, and creditors.

SECTION 5. AUDIT PROTECTION FOR TAXPAYERS CURRENTLY USING THE REPLACEMENT COST METHOD

A taxpayer within the scope of this revenue procedure that is using the replacement cost method provided in section 4 of this revenue procedure on March 12, 2002, may continue to use this safe harbor method for taxable years ending on or after March 12, 2002, without filing a Form 3115, *Application for Change in Accounting Method*. Such taxpayer's method of using replacement cost to determine cost for its vehicle parts inventory will not be raised as an issue in a taxable year that ends before December 31, 2001. Moreover, if such taxpayer's method of using replacement cost to determine cost for its vehicle parts inventory is already an issue under consideration in a taxable year that ends before December 31, 2001, the issue will not be further pursued.

SECTION 6. CHANGE IN METHOD OF ACCOUNTING

.01 *In General*. A change to the replacement cost method provided by this revenue procedure is a change in method of accounting to which the provisions of § 446 and the regulations thereunder apply. Therefore, a taxpayer within the scope of this revenue procedure that does not use the replacement cost method provided in section 4 of this revenue procedure on March 12, 2002, but wants to use this safe harbor method for a taxable year ending on or after December 31, 2001, must file a Form 3115.

.02 *Automatic change to the replacement cost method*. A taxpayer within the scope of this revenue procedure that wants to change its method of determining cost to the replacement cost method provided by this revenue procedure must follow the automatic change in accounting method provisions of Rev. Proc. 2002–9 (2002–3 I.R.B. 327) with the following modifications:

(1) The scope limitations in section 4.02 of Rev. Proc. 2002–9 do not apply to a taxpayer that wants to make the change for its first or second taxable year ending on or after December 31, 2001;

(2) A change to the replacement cost method under the provisions of Rev. Proc. 2002–9 must be effected on a cut-off method. Thus, the change in method of accounting is made without a § 481(a) adjustment;

(3) A taxpayer making a change under this section 6.02 of this revenue procedure for its first taxable year ending on or after December 31, 2001, that before April 11, 2002, filed its original federal income tax return for such year is not required to comply with the filing requirement in section 6.02(3)(a) of Rev. Proc. 2002–9, provided the taxpayer complies with the following filing requirement. The taxpayer must complete and file a Form 3115 in duplicate. The original must be attached to an amended federal income tax return for the taxpayer's first taxable year ending on or after December 31, 2001. This amended return must be filed no later than September 9, 2002. A copy of the Form 3115 must be filed with the national office (see section

6.02(6) of Rev. Proc. 2002–9) no later than when the taxpayer's amended return is filed; and

(4) When filing the Form 3115, taxpayers must complete all applicable parts of the form and, in lieu of the label required by section 6.02(4) of Rev. Proc. 2002–9, are instructed to write "Filed under Rev. Proc. 2002–17" at the top of the form.

.03 *Audit Protection*. If a taxpayer complies with the requirements of this revenue procedure and changes its method of determining cost for its vehicle parts inventory to the replacement cost method provided in section 4 of this revenue procedure, the taxpayer will receive audit protection for any taxable year before the year of change with respect to the taxpayer's method of determining cost for its vehicle parts inventory under § 471 or 472. See section 7 of Rev. Proc. 2002–9. However, if this change in method of accounting is made for the taxpayer's first or second taxable year ending on or after December 31, 2001, and the taxpayer's method of determining cost (other than by use of replacement cost) for its vehicle parts inventory under § 471 or 472 is an issue under consideration as of March 12, 2002, in a taxable year that ends before December 31, 2001, the taxpayer will not receive audit protection.

SECTION 7. RECORD KEEPING

Section 6001 provides that every person liable for any tax imposed by the Code, or for the collection thereof, must keep such records, render such statements, make such returns, and comply with such rules and regulations as the Secretary may from time to time prescribe. The books or records required by § 6001 must be kept at all times available for inspection by authorized internal revenue officers or employees, and must be retained so long as the contents thereof may become material in the administration of any internal revenue law. Section 1.6001–1(e). In order to satisfy the record keeping requirements of § 6001 and the regulations thereunder, a taxpayer that uses the replacement cost method should maintain records supporting all aspects of its inventory valuation including, but not limited to, the price list described in section 4 of this revenue procedure.

SECTION 8. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 2002–9 is modified and amplified to include this automatic change in section 10.02 of the APPENDIX.

SECTION 9. EFFECTIVE DATE

This revenue procedure generally is effective for taxable years ending on or after December 31, 2001.

DRAFTING INFORMATION

The principal author of this revenue procedure is Scott Rabinowitz of the Office of Associate Chief Counsel (Income Tax & Accounting). For further information regarding this revenue procedure, contact Mr. Rabinowitz at (202) 622–4970 (not a toll-free number).

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26 CFR 601.105: Examination of returns and claims for refund, credit, or abatement; determination of correct tax liability.
(Also Part 1, §§ 446, 481; 1.446–1, 1.481–1)

Rev. Proc. 2002–18

DRAFTING INFORMATION

SECTION 1. PURPOSE

.01 *In General*. This revenue procedure provides the procedures under § 446(b) of the Internal Revenue Code and § 1.446–1(b) of the Income Tax Regulations for changes in method of accounting imposed by the Internal Revenue Service (Service). This revenue procedure also provides the procedures that the Service will use for accounting method issues resolved by the Service on a nonaccounting-method-change basis.

.02 *Voluntary Compliance*. This revenue procedure provides terms and conditions for Service-imposed changes in method of accounting that are intended to encourage taxpayers to voluntarily request a change from an impermissible method of accounting prior to being contacted for examination. Under this approach, a taxpayer that is contacted for examination and required to change its method of accounting by the Service ("involuntary change") generally receives less favorable terms and conditions when the change results in a positive § 481(a) adjustment than the taxpayer would have received if it had filed an application to change its method of accounting ("voluntary change") before the taxpayer was contacted for examination. For example, an involuntary change generally is made with an earlier year of change and a shorter § 481(a) adjustment period for a positive adjustment, and a voluntary change generally is made with a current year of change and a longer § 481(a) adjustment period for a positive adjustment. *See* Rev. Proc. 97–27 (1997–1 C.B. 680) as modified by Rev. Proc. 2002–19 (2002–13 I.R.B. 696) and Rev. Proc. 2002–9 (2002–3 I.R.B. 327) as modified by Ann. 2002–17 (2002–8 I.R.B. 561), and Rev. Proc. 2002–19 (2002–13 I.R.B. 696) which provide the procedures for voluntary requests to change an accounting method.

.03 *Procedures for Examination, Appeals, and Counsel for the Government for Resolving Accounting Method Issues*. This revenue procedure sets forth procedures for Examination, Appeals, and counsel for the government to resolve accounting method issues. It does not alter Examination's authority to examine the returns of a taxpayer. It provides parameters for Examination to resolve accounting method issues, but does not limit or expand Examination's authority to resolve any issues under any applicable

Delegation Order (*e.g.*, Delegation Order No. 236, Application of Appeals Settlement to Coordinated Examination Program Taxpayers, and Delegation Order No. 247, Authority of Examination Case Managers to Accept Settlement Offers and Execute Closing Agreements on Industry Specialization Program and International Field Assistance Program Issues). This revenue procedure also does not alter or limit the authority of Appeals or counsel for the government to resolve or settle any issues.

SECTION 2. BACKGROUND

.01 *Change in Method of Accounting Defined*.

(1) Section 1.446–1(e)(2)(ii)(a) provides that a change in method of accounting includes a change in the overall plan of accounting for gross income or deductions, or a change in the treatment of any material item. A material item is any item that involves the proper time for the inclusion of the item in income or the taking of the item as a deduction. In determining whether a taxpayer's accounting practice for an item involves timing, generally the relevant question is whether the practice permanently changes the amount of the taxpayer's lifetime income. If the practice does not permanently affect the taxpayer's lifetime income, but does or could change the taxable year in which income is reported, it involves timing and is therefore a method of accounting. *See* Rev. Proc. 91–31 (1991–1 C.B. 566).

(2) Although a method of accounting may exist under this definition without a pattern of consistent treatment of an item, a method of accounting is not adopted in most instances without consistent treatment. The treatment of a material item in the same way in determining the gross income or deductions in two or more consecutively filed tax returns (without regard to any change in status of the method as permissible or impermissible) represents consistent treatment of that item for purposes of § 1.446–1(e)(2)(ii)(a). If a taxpayer treats an item properly in the first return that reflects the item, however, the taxpayer has adopted a method of accounting for that item. If a taxpayer has adopted a method of accounting under these rules, the taxpayer may not change the method by amending its prior income tax returns(s). *See* Rev. Rul. 90–38 (1990–1 C.B. 57). Rather, a taxpayer that wants to change its method of accounting must follow either the automatic method change procedures of Rev. Proc. 2002–9 (or its successor), if applicable, or the advance consent procedures of Rev. Proc. 97–27 (or its successor).

(3) Section 1.446–1(e)(2)(ii)(*b*) of the regulations provides examples of circumstances that do not constitute changes in method of accounting, including:

(a) correction of mathematical or posting errors, or errors in the computation of tax liability (such as errors in computation of the foreign tax credit, net operating loss, percentage depletion, or investment credit);

(b) adjustment of any item of income or deduction that does not involve the proper time for the inclusion of the item or the taking of a deduction; and

(c) a change in treatment resulting from a change in underlying facts.

.02 *Method Changes Imposed by the Service.*

(1) Section 446(b) and § 1.446–1(b)(1) provide that if a taxpayer does not regularly employ a method of accounting that clearly reflects its income, the computation of taxable income must be made in the manner that, in the opinion of the Commissioner, does clearly reflect income.

(2) The Commissioner has broad discretion in determining whether a taxpayer's method of accounting clearly reflects income, and the Commissioner's determination must be upheld unless it is clearly unlawful. *See Thor Power Tool Co. v. Commissioner*, 439 U.S. 522 (1979); *RCA Corp. v. United States*, 664 F.2d 881 (2nd Cir. 1981), *cert. denied*, 457 U.S. 1133 (1982).

(3) The Commissioner has broad discretion in selecting a method of accounting that the Commissioner believes properly reflects the income of a taxpayer once the Commissioner has determined that the taxpayer's method of accounting does not clearly reflect income, and the Commissioner's selection may be challenged only upon showing an abuse of discretion by the Commissioner. *See Wilkinson-Beane, Inc. v. Commissioner*, 420 F.2d 352 (1st Cir. 1970); *Standard Paving Co. v. Commissioner*, 190 F.2d 330 (10th Cir.), *cert. denied*, 342 U.S. 860 (1951).

(4) The Commissioner has the discretion to change a taxpayer's method of accounting even though the Commissioner previously changed the taxpayer to the method if the Commissioner determines that the method of accounting does not clearly reflect the taxpayer's income. The Commissioner is not precluded from correcting mistakes of law in determining a taxpayer's tax liability, including the power to retroactively correct rulings or other determinations on which the taxpayer may have relied. *See Dixon v. United States*, 381 U.S. 68 (1965); *Automobile Club of Michigan v. Commissioner*, 353 U.S. 180 (1957); *Massaglia v. Commissioner*, 286 F.2d 258 (10th Cir. 1961).

(5) The Commissioner does not have discretion, however, to require a taxpayer to change from a method of accounting that clearly reflects income to a method that, in the Commissioner's view, more clearly reflects income. *See Capitol Federal Savings & Loan v. Commissioner*, 96 T.C. 204 (1991); *W.P. Garth v. Commissioner*, 56 T.C. 610 (1971), *acq*., 1975–1 C.B. 1.

(6) The Commissioner may change the accounting method of a taxpayer that is under examination, before an appeals office, or before a federal court, except as otherwise provided in published guidance. See, for example, section 9 of Rev. Proc. 97–27, which generally precludes the Service from changing a taxpayer's method of accounting for an item for prior taxable years if the taxpayer timely files a Form 3115, *Application to Change a Method of Accounting*, pursuant to Rev. Proc. 97–27 requesting to change its method of accounting for the item.

.03 *No Right to Retroactive Method Change*. Although the Commissioner is authorized to consent to a retroactive accounting method change, a taxpayer does not have a right to a retroactive change, regardless of whether the change is from a permissible or impermissible method. *See generally*, Rev. Rul. 90–38.

.04 *Method Change With a § 481(a) Adjustment*.

(1) *Need for adjustment*. Section 481(a) requires those adjustments necessary to prevent amounts from being duplicated or omitted to be taken into account when the taxpayer's taxable income is computed under a method of accounting

different from the method used to compute taxable income for the preceding taxable year. When there is a change in method of accounting to which § 481(a) is applied, income for the taxable year preceding the year of change must be determined under the method of accounting that was then used, and income for the year of change and the following taxable years must be determined under the new method of accounting as if the new method had always been used.

Example. A taxpayer, although not permitted to use the cash receipts and disbursements method of accounting by § 448, uses the overall cash method and changes to an overall accrual method. The taxpayer has $120,000 of income earned but not yet received (accounts receivable) and $100,000 of expenses incurred but not yet paid (accounts payable) as of the end of the taxable year preceding the year of change. A positive § 481(a) adjustment of $20,000 ($120,000 accounts receivable less $100,000 accounts payable) is required as a result of the change.

(2) *Adjustments attributable to pre-1954 years*. Section 481(a)(2) and § 1.481–3 provide that if the adjustments required by § 481(a) are attributable to a change in method of accounting not initiated by the taxpayer, no portion of any adjustments which is attributable to pre-1954 taxable years is taken into account in computing taxable income.

(3) *Adjustment period*. Section 481(c) and §§ 1.446–1(e)(3)(i) and 1.481–4 provide that the adjustment required by § 481(a) may be taken into account in determining taxable income in the manner and subject to the conditions agreed to by the Commissioner and the taxpayer. Generally, in the absence of such an agreement, the § 481(a) adjustment is taken into account in computing taxable income completely in the year of change. However, § 481(b) may limit the amount of tax attributable to a substantial § 481(a) adjustment that increases taxable income.

.05 *Method Change Using a Cut-off Method*. The Commissioner may determine that certain changes in method of accounting will be made without a § 481(a) adjustment, using a "cut-off method." Under a cut-off method, only the items arising on or after the beginning of the year of change are accounted for under the new method of accounting. Any items arising before the year of change continue to be accounted for under the taxpayer's former method of accounting. Because no items are duplicated or omitted from income when a cut-off method is used to effect a change in accounting method, no § 481(a) adjustment is necessary.

.06 *Previous Method Change Without Consent*. The Commissioner may require a taxpayer that has changed a method of accounting without the Commissioner's consent to change back to its former method. The Commissioner may do so even when the taxpayer changed from an impermissible to a permissible method. The change back to the former method may be made in the taxable year the taxpayer changed without consent, or if that year is closed by the running of the period of limitations, in the earliest open year. *See Commissioner v. O. Liquidating Corp.*, 292 F.2d 225 (3rd Cir.), *cert. denied*, 368 U.S. 898 (1961); *Wright Contracting Co. v. Commissioner*, 316 F.2d 249 (5th Cir., 1963), *cert. denied* 375 U.S. 879 (1963), *reh'g denied* 375 U.S. 981 (1964), *acq.* 1966–2 C.B. 7; *Daktronics, Inc. v. Commissioner*, T.C. Memo. 1991–60; *Handy Andy T.V. and Appliances, Inc. v. Commissioner*, T.C. Memo. 1983–713. For example, the Service may change a taxpayer back to its former impermissible method of accounting if the taxpayer changed to a permissible method of accounting without the Commissioner's consent and miscalculated the § 481(a) adjustment, even where the statute of limitations has expired for the year of change.

.07 *Penalties*. Any otherwise applicable penalty for the failure of a taxpayer to change its method of accounting (for example, the accuracy-related penalty under § 6662 or the fraud penalty under § 6663) may be imposed if the Service imposes an accounting method change. *See* § 446(f). Additionally, the taxpayer's return preparer may also be subject to the preparer penalty under § 6694.

SECTION 3. DEFINITIONS

.01 *Accounting Method Issue*. The term "accounting method issue" means an issue regarding whether the taxpayer's accounting treatment of an item is proper, but only if changing the taxpayer's treatment of such item could constitute a change in method of accounting. See the definition of change in method of accounting in § 1.446–1(e)(2) and section 2.01 of this revenue procedure.

.02 *Year of Change*. The year of change is the taxable year for which a change in method of accounting is effective, that is, the first taxable year the new method is used, even if no affected items are taken into account for that year. The year of change is also the first taxable year for complying with all the terms and conditions accompanying the change.

.03 *Section 481(a) Adjustment Period*. The § 481(a) adjustment period is the applicable number of taxable years for taking into account the § 481(a) adjustment required as a result of the change in method of accounting. The year of change is the first taxable year in the adjustment period and the § 481(a) adjustment is taken into account ratably over the number of taxable years in the adjustment period.

.04 *Taxpayer*. The term "taxpayer" has the same meaning as the term "person" defined in § 7701(a)(1) (rather than the meaning of the term "taxpayer" defined in § 7701(a)(14)).

SECTION 4. SCOPE

Except as otherwise provided in published guidance, this revenue procedure applies to any accounting method change imposed by the Service, and to any accounting method issue resolved by the Service on a nonaccounting-method-change basis.

SECTION 5. EXAMINATION DISCRETION TO RESOLVE ACCOUNTING METHOD ISSUES

.01 *In General*. Using professional judgment in accordance with auditing standards, an examining agent will make findings of fact and apply Service position on issues of law to determine whether an issue is an accounting method issue (as defined by section 3.01 of this revenue procedure) and whether the taxpayer's method of accounting is permissible. *See* Policy Statement P–4–117. Except as otherwise provided in published guidance (for example, Delegation Order No. 236), the discretion of an examining agent to resolve an accounting method issue is set forth in sections 5.02 through 5.06 of this revenue procedure.

See section 10.01 of this revenue procedure for an example of the application of section 5 of this revenue procedure.

.02 *Requirement to Treat an Accounting Method Issue as a Method Change*. An examining agent who determines that a taxpayer's method of accounting is impermissible, or that a taxpayer changed its method of accounting without obtaining the consent of the Commissioner, may propose an adjustment with respect to that method only by changing the taxpayer's method of accounting.

.03 *Selection of New Method of Accounting*. Except as provided in section 2.06 of this revenue procedure, an examining agent changing a taxpayer's method of accounting will select a new method of accounting by properly applying the law to the facts determined by the agent. The method selected must be a proper method of accounting and will not be a method contrived to reflect the hazards of litigation.

Example. A taxpayer held long-term zero coupon bonds during the taxable year under examination but did not include any original issue discount (OID) in income for that year. The examining agent determines that the taxpayer should have included OID in income for that year under § 1272. Accordingly, the examining agent will change the taxpayer's method of accounting to include the OID in income in accordance with § 1272 and the regulations thereunder. The examining agent will not impose a method of accounting that is designed to take into account litigation hazards (for example, a method that only requires the accrual of an arbitrary percentage of the OID that would otherwise accrue during the year under § 1272 and the regulations thereunder).

.04 *Terms and Conditions of Change*.

(1) *Year of change*. An examining agent changing a taxpayer's method of accounting will make the change in a year under examination. Ordinarily, the change will be made in the earliest taxable year under examination, or, if later, the first taxable year the method is considered to be impermissible. However, in appropriate circumstances, an examining agent may defer the year of change to a later taxable year. For example, an examining agent may defer the year of change if the examining agent determines that:

(a) the taxpayer's books and records do not contain sufficient information to compute a § 481(a) adjustment for the taxable year in which the change would otherwise be imposed and the adjustment cannot be reasonably estimated;

(b) the taxpayer's existing method of accounting does not have a material effect for the taxable year in which the change would otherwise be imposed; or

(c) there are taxable years for which the statute of limitations has expired following the taxable year in which the change would otherwise be imposed.

An examining agent will not defer the year of change in order to reflect the hazards of litigation. Moreover, an examining agent will not defer the year of change to later than the most recent year under examination on the date of the agreement finalizing the change.

(2) *Section 481(a) adjustment*. An examining agent changing a taxpayer's method of accounting ordinarily will impose a § 481(a) adjustment, subject to a computation of tax under § 481(b)(if applicable). However, an examining agent should use a cut-off method to make a change (other than a change within the LIFO inventory method as defined in section 3.09 of Revenue Procedure 97–27 (1997–1 C.B. 680), or a change in method of accounting for intercompany transactions, *see* § 1.1502–13) when a statute, regulation, or administrative pronouncement of the Service effective for the year of change directs that the change be made using a cut-off method. *See, e.g.*, § 174. In addition, an examining agent may use a cut-off method to make a change in appropriate circumstances. For example, the examining agent may use a cut-off method to make a change if the agent determines that the taxpayer's books and records do not contain sufficient information to compute a § 481(a) adjustment and the adjustment cannot be reasonably estimated. Finally, an examining agent will not make a change on a cut-off method in order to reflect the hazards of litigation.

(3) *Spread of § 481(a) adjustment*. The § 481(a) adjustment, whether positive or negative, will be taken into account entirely in the year of change.

SECTION 6. APPEALS AND COUNSEL FOR THE GOVERNMENT DISCRETION TO RESOLVE ACCOUNTING METHOD ISSUES

.01 *Authority to Resolve Accounting Method Issues*. An appeals officer or counsel for the government may resolve an accounting method issue (as defined by section 3.01 of this revenue procedure) when it is in the interest of the government to do so. *See* P–8-47.

.02 *Types of Resolutions*.

(1) *In general*. An appeals officer or counsel for the government may resolve an accounting method issue by using any of the means described in section 6 of this revenue procedure, or any other means deemed appropriate under the circumstances, to reflect the hazards of litigation. See sections 10.02 through 10.04 of this revenue procedure for examples of the application of section 6 of this revenue procedure.

(2) *Accounting method changes*.

(a) *Treating an accounting method issue as a method change*. An appeals officer or counsel for the government resolving an accounting method issue may treat the issue as a change in method of accounting.

(b) *Selection of new method of accounting*. Except as provided in section 2.06 of this revenue procedure, an appeals officer or counsel for the government changing a taxpayer's method of accounting will select a new method of accounting by properly applying the law to the facts. The appeals officer or counsel for the government will not put the taxpayer on an improper method of accounting in order to reflect the hazards of litigation.

(c) *Terms and conditions of change*. An appeals officer or counsel for the government changing a taxpayer's method of accounting may agree to terms and conditions that differ from those ordinarily applicable to an Examination-imposed accounting method change, including the following (or any combination thereof):

(i) *Year of change*. An appeals officer or counsel for the government may compromise the year of change (for example, by agreeing to a later year of change). However, an appeals officer or counsel for the government changing a taxpayer's method of accounting ordinarily will not defer the year of change to

later than the most recent taxable year under examination on the date of the agreement finalizing the change, and, in no event, will defer the year of change to later than the taxable year that includes the date of the agreement finalizing the change;

(ii) *Section 481(a) adjustment.* An appeals officer or counsel for the government may make the change using a § 481(a) adjustment or a cut-off method. If a § 481(a) adjustment is used, the appeals officer or counsel for the government may compromise the amount of the § 481(a) adjustment (for example, by agreeing to a reduced § 481(a) adjustment). If the appeals officer or counsel for the government agrees to compromise the amount of the § 481(a) adjustment, the agreement must be in writing; and

(iii) *Spread of the § 481(a) adjustment.* An appeals officer or counsel for the government may compromise the § 481(a) adjustment period (for example, by agreeing to a longer § 481(a) adjustment period).

(3) *Alternative-timing resolution.* In lieu of changing a taxpayer's method of accounting, an appeals officer or counsel for the government may resolve an accounting method issue by agreeing to alternative timing for all or some of the items arising during, or prior to and during, the taxable years before Appeals or a federal court. The resolution of an accounting method issue on an alternative-timing basis for certain items will not affect the taxpayer's method of accounting for any items not covered by the resolution.

Example. The Service and the taxpayer agree that the taxpayer will capitalize the inventoriable costs incurred during 1999 that were deducted under the taxpayer's method of accounting. The taxpayer's inventoriable costs covered by the agreement must be capitalized and accounted for under the taxpayer's inventory method. The inventoriable costs that are not covered by the agreement (that is, those costs incurred in taxable years prior and subsequent to 1999) are not affected by the resolution and thus, consistent with the taxpayer's method of accounting, must continue to be deducted.

(4) *Time-value of money resolution.*

(a) *In general.* In lieu of changing a taxpayer's method of accounting, an appeals officer or counsel for the government may resolve an accounting method issue by agreeing that the taxpayer will pay the government a "specified amount" that approximates the time-value-of-money benefit the taxpayer has derived from using its method of accounting for the taxable years before appeals or a federal court (instead of the method of accounting determined by the appeals officer or counsel for the government to be the proper method of accounting), reduced by an appropriate factor to reflect the hazards of litigation. If the sum of the time-value-of-money benefit (detriment) computed with respect to each taxable year is negative, the specified amount will be zero and no refund will be made to the taxpayer. The specified amount is not interest under § 163(a), and may not be deducted or capitalized under any provision of the Code. In appropriate circumstances, however, the computation of the specified amount may be tax affected to reflect the approximate effect of a hypothetical tax deduction, as demonstrated in the sample computation. See section 6.02(4)(b)(ii)(B) of this revenue procedure. The specified amount will be treated as a miscellaneous payment as described in the Internal Revenue Manual.

(b) *Computation of specified amount.*

(i) *In general.* An appeals officer or counsel for the government may use any reasonable manner to compute the specified amount, including the sample computation described in section 6.02(4)(b)(ii) of this revenue procedure, or a computation that takes into account the taxpayer's actual tax rates and tax attributes.

(ii) *Sample computation.* Under the sample computation, the specified amount equals the sum of the time-value-of-money benefit (detriment) computed with respect to each taxable year before Appeals or a federal court. The time-value-of-money benefit (detriment) with respect to each taxable year before Appeals or a federal court equals the "hypothetical underpayment (overpayment)" (as defined in section 6.02(4)(b)(ii)(A) of this revenue procedure), multiplied by the "applicable time-value rate" (as defined in section 6.02(4)(b)(ii)(B) of this revenue procedure), compounded daily for the "applicable period" (as defined in section 6.02(4)(b)(ii)(C) of this revenue procedure).

(A) *Hypothetical underpayment (overpayment).* The hypothetical underpayment (overpayment) for each taxable year before Appeals or a federal court is equal to the net increase or decrease in taxable income (including the § 481(a) adjustment) that would have been reflected on the return for the taxable year if the Service had changed the taxpayer's method of accounting (in the earliest taxable year before Appeals or a federal court, or, if later, the first taxable year the method is considered impermissible), multiplied by the applicable tax rate for the taxable year of the underpayment (overpayment). For this purpose, only adjustments associated with the change are taken into account. The applicable tax rate is the highest rate of income tax applicable to the taxpayer (for example, the highest rate in effect under § 1 for individuals or § 11 for corporations).

(B) *Applicable time-value rate.* The applicable time-value rate generally equals an average of the quarterly underpayment rates in effect under § 6621(a) for the applicable period. However, for a taxpayer that would be entitled to a deduction under § 163(a) for the specified amount if the specified amount were treated as interest arising from the underpayment of tax, the applicable time-value rate is computed at a reduced rate equaling an average of the quarterly underpayment rates in effect under § 6621(a) for the applicable period, multiplied by the excess of 100% over the applicable tax rate for the taxable year of the underpayment (overpayment).

(C) *Applicable period.* The applicable period begins on the due date (without regard to extensions) of the return for the taxable year of the underpayment (overpayment) and ends on the date on which the specified amount is paid.

(D) *Processing of specified amount.* The Appeals Officer or government counsel resolving the issue should forward checks in payment of specified amounts to:

Internal Revenue Service
201 W. Riverside Blvd
Manual Deposit Unit
Stop 31, Unit 21
Covington, KY 41019
Attn: Manager, Manual Deposit Unit.

The Manager of the Manual Deposit Unit should be notified by telephone, at (859) 292–5790, that the payment will be sent. The transmittal memorandum should state that the payment is a "Rev. Proc. 2002–18 Specified Amount" payment and should specify the name and TIN of the taxpayer, the type of taxpayer (LMSB, SBSE, W&I), and the year(s) to which the payment pertains.

SECTION 7. PROCEDURES FOR A SERVICE-IMPOSED ACCOUNTING METHOD CHANGE.

.01 *Requirement to Provide Notice to Taxpayer*.

(1) *In general*. An examining agent, appeals officer, or counsel for the government changing a taxpayer's method of accounting will provide notice that an accounting method issue is being treated as an accounting method change. However, an appeals officer or counsel for the government resolving an accounting method issue as an accounting method change is not required to provide notice that the accounting method issue is being treated as an accounting method change if such notice has been provided by the examining agent. In addition, if the examining agent has provided notice that an accounting method issue is being treated as an accounting method change and an appeals officer or counsel for the government subsequently resolves such accounting method issue on a nonaccounting-method-change basis, the appeals officer or counsel for the government should provide notice that the accounting method issue has not been treated as an accounting method change.

(2) *Form of notice*. The notice must be in writing. If the taxpayer and the Service execute a closing agreement finalizing the change, the notice will be provided in the closing agreement. If the taxpayer and the Service do not execute a closing agreement, the notice ordinarily will be provided in the examiner's report or the Form 870AD (Offer of Waiver of Restriction on Assessment and Collection of Deficiency in Tax and of Acceptance of Overpayment). However, the Service may also provide the notice in a preliminary notice of deficiency, a statutory notice of deficiency, a notice of claim disallowance, a notice of final administrative adjustment, a pleading (for example, a petition, complaint, or answer) or amendment thereto, or in any other similar writing provided to the taxpayer.

(3) *Content of notice*. The notice must include:

(a) a statement that the accounting method issue is being treated as an accounting method change or a clearly labeled § 481(a) adjustment; and

(b) a description of the new method of accounting.

(4) *Method not established without notice*. The resolution of an accounting method issue will not establish a new method of accounting if the Service does not provide the notice required by section 7.01 of this revenue procedure. See section 9 of this revenue procedure for the procedures applicable if the Service does not provide this notice.

.02 *Finalizing a Service-imposed Method Change*.

(1) *In general*. To implement a Service-imposed change in method of accounting, the taxpayer and the Service should execute a closing agreement under § 7121 in which the taxpayer agrees to the change and the terms and conditions of the change. For purposes of this revenue procedure, in the case of accounting method issues before a federal court, the term "closing agreement" includes any other appropriate settlement agreement. If the taxpayer and the Service execute such a closing agreement, then the change is final as of the date of the agreement (unless otherwise provided by a federal court). In the absence of such an agreement, a Service-imposed accounting method change is final only 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.

(2) *Content of closing agreement*. A closing agreement finalizing a Service-imposed accounting method change must comply with the requirements of Rev. Proc. 68–16 (1968–1 C.B. 770), and should include the information outlined in the Model Closing Agreement for Settlement on an Accounting Method Basis attached as APPENDIX A of this revenue procedure. A settlement agreement finalizing a Service-imposed accounting method change with respect to an accounting method issue that is pending before a federal court must conform to the rules and procedures of the court and should include the information outlined in the Model Closing Agreement for Settlement on an Accounting Method Change Basis attached as APPENDIX A of this revenue procedure.

.03 *Implementing a Service-imposed Method Change*.

(1) *Years before the Service*. The Service should make the adjustments necessary to effect a Service-imposed accounting method change to the taxpayer's returns for the taxable years under examination, before Appeals, or before a federal court. These adjustments include the adjustments to taxable income necessary to reflect the new method (including the § 481(a) adjustment required as a result of the change), and any collateral adjustments to taxable income or tax liability resulting from the change.

(2) *Succeeding years for which returns have been filed*. If a Service-imposed accounting method change is finalized by a closing agreement, the Service may require that the taxpayer file amended returns to reflect the change for any affected succeeding taxable years for which a federal income tax return has been filed as of the date of the agreement. The amended returns must include the adjustments to taxable income and any collateral adjustments to taxable income or tax liability resulting from the change necessary to reflect the new method. The Service may require that the amended returns be filed prior to execution of the closing agreement finalizing the change. If the Service does not require the amended returns, the taxpayer should file such amended returns. If the Service does not require the amended returns and the taxpayer does not file the amended returns, the Service should make the adjustments necessary to reflect the change for affected succeeding taxable years if and when it examines the returns for those years. A taxpayer that files an amended return using the new method prior to the date a Service-imposed change becomes final must continue to use the new method on all subsequent returns, unless the taxpayer obtains the consent of the Commissioner to change from the new method or the Service changes the taxpayer from the new method on subsequent examination. *See* Rev. Rul. 90–38. A taxpayer eligible to

file a "qualified amended return" under Rev. Proc. 94–69 (1994–2 C.B. 804) may satisfy any requirement to file an amended return by filing a "qualified amended return" in accordance with that revenue procedure.

(3) *Future years*. The taxpayer must use the new method of accounting on all returns filed after the date that a Service-imposed accounting method change becomes final (*see* section 7.02 of this revenue procedure), unless the taxpayer obtains the consent of the Commissioner to change from the new method or the Service changes the taxpayer from the new method on subsequent examination. A taxpayer that files a return using the new method prior to the date a Service-imposed change becomes final must continue to use the new method on all subsequent returns, unless the taxpayer obtains the consent of the Commissioner to change from the new method or the Service changes the taxpayer from the new method on subsequent examination. If the taxpayer does not use the new method on any return filed prior to the date a Service-imposed change becomes final, and does not file amended returns to reflect the change, the Service should make the adjustments necessary to reflect the change for the affected taxable years if and when it examines those returns.

.04 *Effect of Final Service-imposed Method Change.*

(1) *New method established*. A Service-imposed change that is final establishes a new method of accounting within the meaning of § 446(e) and § 1.446–1(e). As a result, the taxpayer is required to use the new method of accounting for the year of change and for all subsequent taxable years, unless the taxpayer obtains the consent of the Commissioner to change from the new method or the Service changes the taxpayer from the new method on subsequent examination.

(2) *Subsequent examination*. Except as provided in section 7.04(3) of this revenue procedure, the Service is not precluded from changing the taxpayer from the new method of accounting if the Service determines that the new method does not clearly reflect the taxpayer's income.

(3) *Audit protection*.

(a) *In general*. A taxpayer that executes a closing agreement finalizing a Service-imposed accounting method change will not be required to change or modify the new method for any taxable year for which a federal income tax return has been filed 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) there has been no taxpayer fraud, malfeasance, or misrepresentation of 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.

(b) *Limitations*. The Service may require the taxpayer to change or modify the new method in the earliest open taxable year if the taxpayer fails to comply with the applicable provisions of the agreement or upon a showing of the taxpayer's fraud, malfeasance, or misrepresentation of a material fact. The Service may require the taxpayer to change or modify the new method in the earliest open taxable year in which the material facts have changed. The Service also may require the taxpayer to change or modify the new method in the earliest open taxable year in which the applicable law has changed. For this purpose, a change in the applicable law includes: (i) the enactment of legislation; (ii) a decision of the United States Supreme Court; (iii) the issuance of temporary or final regulations; or (iv) the issuance of a revenue ruling, revenue procedure, notice, or other guidance published in the Internal Revenue Bulletin.

.05 *Coordination with Examination*. An appeals officer or counsel for the government changing a taxpayer's method of accounting will coordinate the resolution with Examination if the appeals officer or counsel for the government proposes to defer the year of change to any taxable year not before appeals or a federal court. Examination will advise the appeals officer or counsel for the government of any changes in material fact in any taxable year under examination.

.06 *Deemed Cut-off Method*. If the Service does not impose a § 481(a) adjustment but otherwise provides the notice required by section 7.01 of this revenue procedure, the Service-imposed change will be treated as being made using a cut-off method, unless the Service and the taxpayer specifically have agreed in writing to compromise the amount of the § 481(a) adjustment.

SECTION 8. PROCEDURES FOR RESOLVING ACCOUNTING METHOD ISSUES ON A NONACCOUNTING-METHOD-CHANGE BASIS

.01 *Closing agreement required*. To resolve an accounting method issue raised by the Service on a nonaccounting-method-change basis, the Service and the taxpayer will execute a closing agreement under § 7121. For purposes of this revenue procedure, in the case of accounting method issues before a federal court, the term "closing agreement" includes any other appropriate settlement agreement. If the accounting method issue is being resolved on an alternative-timing basis as described in section 6.02(3) of this revenue procedure, the taxpayer must agree to pay the government any taxes and interest due as a result of the resolution. If the accounting method issue is being resolved on a time-value-of-money basis as described in section 6.02(4) of this revenue procedure, the taxpayer must agree to pay the government the specified amount as a result of the resolution.

.02 *Content of Closing Agreement*. A closing agreement finalizing the resolution of an accounting method issue on a nonaccounting-method-change basis must comply with the requirements of Rev. Proc. 68–16, and should include the information outlined in the Model Closing Agreement for Settlement on a Nonaccounting-method-change Basis attached as APPENDIX B of this revenue procedure. A closing agreement resolving an accounting method issue that is pending before a federal court on a nonaccounting-method-basis must conform to the rules and procedures of the court and should include the information outlined in the Model Closing Agreement for Settlement on a Nonaccounting-method-change Basis attached as APPENDIX B of this revenue procedure.

.03 *Implementing Resolution of an Accounting Method Issue on a Nonaccounting-method-change Basis.*

(1) *Resolution on an alternative-timing basis*.

(a) *Years before the Service*. The Service should make the adjustments necessary to effect an alternative-timing resolution for the taxable years before appeals or before a federal court. These adjustments include the adjustments to taxable income necessary to reflect the resolution and any collateral adjustments to taxable income or tax liability resulting from the resolution.

(b) *Succeeding years for which returns have been filed*. The Service may require that the taxpayer file amended returns to reflect an alternative-timing resolution for any affected succeeding taxable years for which a federal income tax return has been filed as of the date of the closing agreement. The amended returns must include the adjustments to taxable income and any collateral adjustments to taxable income or tax liability resulting from the resolution necessary to reflect the resolution. The Service may require that the amended returns be filed prior to execution of the closing agreement finalizing the resolution. If the Service does not require the amended returns, the taxpayer should file such amended returns. If the Service does not require amended returns and the taxpayer does not file amended returns, the Service should make the adjustments necessary to reflect the resolution for affected succeeding taxable years if and when it examines the returns for those years. A taxpayer eligible to file a "qualified amended return" under Rev. Proc. 94–69 may satisfy any requirement to file an amended return by filing a "qualified amended return" in accordance with that revenue procedure.

(c) *Future years*. The taxpayer must reflect the alternative-timing resolution on the returns for any affected succeeding taxable years for which a return has not been filed as of the date of the closing agreement. The taxpayer must continue to file its returns on its current method of accounting for all items not covered by the closing agreement, unless the taxpayer obtains the consent of the Commissioner to change from its current method or the Service changes the taxpayer from its current method on subsequent examination.

(2) *Resolution on a time-value-of-money basis*. The taxpayer must pay the specified amount required by the time-value-of-money resolution. The Service will not change or otherwise propose adjustments to taxable income with respect to the taxpayer's method of accounting for the taxable years covered by a closing agreement. The taxpayer must continue to file its returns on its current method of accounting, unless the taxpayer obtains the consent of the Commissioner to change from its current method or the Service changes the taxpayer from its current method on subsequent examination.

.04 *Effect of Resolving an Accounting Method Issue on a Nonaccounting-method-change Basis*.

(1) *No change in method*. If the Service resolves an accounting method issue on a nonaccounting-method-change basis, the resolution does not constitute a change in method of accounting. If the accounting method issue is resolved on an alternative-timing basis, the taxpayer is required to use its current method of accounting for all items not covered by the closing agreement, unless the taxpayer obtains the consent of the Commissioner to change from its current method or the Service changes the taxpayer from its current method on subsequent examination. If the accounting method issue is resolved on a time-value-of-money basis, the taxpayer is required to continue to use its current method of accounting on all returns for taxable years subsequent to the years covered by the closing agreement, unless the taxpayer obtains the consent of the Commissioner to change from its current method or the Service changes the taxpayer from its current method on subsequent examination.

(2) *Subsequent change*.

(a) *Resolution on an alternative-timing basis*. If an accounting method issue is resolved on an alternative-timing basis, the Service is not precluded from changing the taxpayer's method of accounting in any open taxable year for any item not covered by the closing agreement.

(b) *Resolution on a time-value-of-money basis*. If an accounting method issue is resolved on a time-value-of-money basis, the Service is not precluded from changing the taxpayer's method of accounting in any open taxable year not covered by the closing agreement.

(3) *Effect of subsequent change*.

(a) *Resolution on an alternative-timing basis*. If an accounting method issue is resolved on an alternative-timing basis and the taxpayer's method of accounting subsequently is changed (voluntarily or involuntarily) in any open taxable year, the § 481(a) adjustment (if any) will be determined by reference to all items arising prior to the year of change, except those items covered by the closing agreement (that is, those items for which the closing agreement specifically provides the manner in which the items are to be accounted for).

(b) *Resolution on a time-value-of-money basis*. If an accounting method issue is resolved on a time-value-of-money basis and the taxpayer's method of accounting subsequently is changed (voluntarily or involuntarily) in any open taxable year not covered by the closing agreement, the § 481(a) adjustment (if any) will be determined by reference to all items arising prior to the year of change. If the Service subsequently changes the taxpayer's method of accounting and imposes a § 481(a) adjustment, the interest that is assessed on any underpayment, or the interest that is due on any overpayment, for the year of change 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.

SECTION 9. DEFAULT PROCEDURES

.01 *In General*. Section 9 of this revenue procedure applies to the resolution of any accounting method issue if the Service changes the taxpayer's method of accounting and fails to provide the notice required by section 7.01 of this revenue procedure, or if the Service resolves the accounting method issue on a nonaccounting-method-change basis and the Service and the taxpayer do not execute a closing agreement as required by section 8.01 of this revenue procedure. See section 10.05 of this revenue procedure for an example of the application of section 9 of this revenue procedure.

.02 *Effect of Adjustments*. For accounting method issues resolved under section 9 of this revenue procedure:

(1) *No omission or duplication*. The Service and the taxpayer are required to treat all items in a manner that prevents

the duplication or omission of items of income or deduction;

(2) *No change in method*. The resolution does not constitute a change in method of accounting. The taxpayer is required to continue to use its current method of accounting for all items not affected by the adjustments made by the Service, unless the taxpayer obtains the consent of the Commissioner to change from its current method or the Service changes the taxpayer from its current method on subsequent examination;

(3) *Subsequent change*. The Service is not precluded from changing the taxpayer's method of accounting in any open taxable year; and

(4) *Effect of subsequent change*. If the taxpayer's method of accounting subsequently is changed (voluntarily or involuntarily) in any open taxable year, the § 481(a) adjustment (if any) will be determined by reference to all items arising prior to the year of change, including the items affected by the adjustment made by the Service.

SECTION 10. EXAMPLES.

The following examples illustrate how the provisions of this revenue procedure apply to the resolution of accounting method issues in various circumstances. These examples include explanations of the resolution of an accounting method issue previously resolved by Appeals on a nonaccounting-method-change basis in the event that Examination resolves such issue in a subsequent taxable year by changing the taxpayer's method of accounting. Note, however, that where the resolution of an accounting method issue is imposed by Appeals, an examining agent addressing such issue in a subsequent taxable year may resolve it consistently with the prior resolution by Appeals (*see* Delegation Order 236).

.01 *Examination-imposed Change*.

(1) *Facts*. A taxpayer that is a corporation deducted costs that the Service determines should have been capitalized to real property that was placed in service in 2000. The taxpayer incurred and deducted $1,000,000 of the costs in 1996, $2,000,000 in each of 1997 and 1998, and $5,000,000 in each of 1999 and 2000. The taxpayer is examined for the 1997 and 1998 taxable years (1997 is the earliest open year). The examining agent determines that the treatment of the costs is an accounting method issue, and that the taxpayer's deduction of the costs is an impermissible method of accounting. The examining agent therefore proposes an adjustment.

(2) *Effect*. Under section 5 of this revenue procedure, the examining agent is required to properly apply the law to the facts and change the taxpayer to the capitalization method of accounting for the costs. The examining agent imposes the change in 1997, the earliest open taxable year. The examining agent will provide the notice required by section 7.01 of this revenue procedure. The examining agent imposes a § 481(a) adjustment of $1,000,000 (representing the $1,000,000 of the costs deducted in 1996), the entire amount of which will be taken into account in computing taxable income in 1997. The examining agent also disallows the deductions of $2,000,000 in each of 1997 and 1998. The taxpayer's basis in the property as of the beginning of 1998 is increased by $5,000,000 (representing the $1,000,000 § 481(a) adjustment and the disallowance of the $2,000,000 of deductions in each of 1997 and 1998). The method change (once final) is effective for 1997. Thus, the taxpayer is required to capitalize the costs in 1997 and all subsequent taxable years, unless the taxpayer obtains the consent of the Commissioner to change the method or the Service changes the taxpayer from the method on subsequent examination.

.02 *Appeals Resolution of Accounting Method Issue as a Method Change With Compromise Terms and Conditions*.

(1) *Facts*. The facts are the same as in section 10.01 of this revenue procedure, except that the issue of whether the costs should be capitalized is referred to Appeals. The appeals officer believes that hazards of litigation exist with respect to the Service's position. The appeals officer and the taxpayer agree to resolve the accounting method issue by changing the taxpayer's method of accounting for the costs, but with compromise terms and conditions to reflect the hazards of litigation.

(2) *Effect*. Under section 6.02(2) of this revenue procedure, when the appeals officer changes the taxpayer's method of accounting, the appeals officer is required to properly apply the law to the facts and change the taxpayer to the capitalization method of accounting for the costs. The appeals officer should provide the notice required by section 7.01 of this revenue procedure.

The appeals officer may make the change using the cut-off method. If the appeals officer makes the change in 1997 using the cut-off method, the appeals officer will disallow the deductions of $2,000,000 in each of 1997 and 1998. The taxpayer's basis in the property as of the beginning of 1998 will be increased by $4,000,000 (representing the disallowance of the $2,000,000 of deductions in each of 1997 and 1998). The method change (once final) is effective for 1997. Thus, the taxpayer is required to capitalize the costs in 1997 and all subsequent taxable years, unless the taxpayer obtains the consent of the Commissioner to change the method or the Service changes the taxpayer from the method on subsequent examination.

Alternatively, the appeals officer may compromise the amount of the § 481(a) adjustment. If the appeals officer makes the change in 1997 and agrees to reduce the § 481(a) adjustment by 25%, the appeals officer will impose a § 481(a) adjustment of $750,000 (representing 75% of the amount of the costs deducted in 1996), the entire amount of which will be taken into account in computing taxable income in 1997. The appeals officer will disallow the deductions of $2,000,000 in each of 1997 and 1998. The taxpayer and the appeals officer agree in a closing agreement that basis in the property as of the beginning of 1998 will be increased by $4,750,000 (representing the reduced § 481(a) adjustment of $750,000 and the disallowance of the $2,000,000 of deductions in each of 1997 and 1998). The method change (once final) is effective for 1997. Thus, the taxpayer is required to capitalize the costs in 1997 and all subsequent taxable years, unless the taxpayer obtains the consent of the Commissioner to change the method or the Service changes the taxpayer from the method on subsequent examination.

As another alternative, the appeals officer may compromise the year of change and/or the § 481(a) adjustment period. For example, the appeals officer may agree to make the change in 1998 with a two-year § 481(a) adjustment

period. The appeals officer will impose a § 481(a) adjustment of $3,000,000 (representing the $1,000,000 of costs deducted in 1996 and the $2,000,000 of costs deducted in 1997), one-half of which will be taken into account in computing taxable income in each of 1998 and 1999. The appeals officer will disallow the deduction of $2,000,000 in 1998. The taxpayer's basis in the property as of the beginning of 1998 will be increased by $5,000,000 (representing the $3,000,000 § 481(a) adjustment and the disallowance of the $2,000,000 of deductions in 1998). The method change (once final) is effective for 1998. Thus, the taxpayer is required to capitalize the costs in 1998 and all subsequent taxable years, unless the taxpayer obtains the consent of the Commissioner to change the method or the Service changes the taxpayer from the method on subsequent examination.

.03 *Appeals Resolution of Accounting Method Issue on an Alternative-timing Basis*.

(1) *Facts*. The facts are the same as in section 10.02 of this revenue procedure, except that the appeals officer and the taxpayer agree to resolve the issue on an alternative-timing basis as described in section 6.02(3) of this revenue procedure and they enter into a closing agreement as required by section 8.01 of this revenue procedure. The accounting method issue is resolved by providing in the closing agreement that the taxpayer will deduct 50% of the costs incurred in 1997 and 1998 and capitalize the other 50% of the costs incurred in those years.

(2) *Effect*. The appeals officer will disallow $1,000,000 of the deductions in each of 1997 and 1998. The taxpayer's basis in the property as of the beginning of 1998 is increased by $2,000,000 (representing the disallowance of the $1,000,000 of deductions in each of 1997 and 1998). The taxpayer's current method of accounting for the costs is not changed. Thus, the taxpayer is required to continue to deduct the costs not covered by the agreement (that is, the costs incurred in 1996 and the costs incurred in 1999 and all subsequent taxable years), unless the taxpayer obtains the consent of the Commissioner to change the method or the Service changes the taxpayer from the method on subsequent examination. If the Service changes the taxpayer's method in 1999, the Service will compute a § 481(a) adjustment of $1,000,000 (including the amount of the costs deducted in 1996, which are not covered by the agreement, and excluding the amount of those costs deducted in 1997 and 1998 because the costs are covered by the agreement). The Service will also disallow the deduction of $5,000,000 in 1999. The taxpayer's basis in the property as of the beginning of 1999 will be increased by an additional $6,000,000 (representing the $1,000,000 § 481(a) adjustment and the disallowance of the $5,000,000 deduction in 1999). The method change (once final) is effective for 1999. Thus, the taxpayer is required to capitalize the costs in 1999 and all subsequent taxable years, unless the taxpayer obtains the consent of the Commissioner to change the method or the Service changes the taxpayer from the method on subsequent examination.

Alternatively, the accounting method issue may be resolved by providing in the closing agreement that the taxpayer will capitalize $1,000,000 of the costs incurred in each of 1997 and 1998 (and the agreement is silent as to the manner in which the other $1,000,000 of costs incurred in each of 1997 and 1998 are to be accounted for). The results for 1997 and 1998 will be the same as under the closing agreement in the original facts described in section 10.03(1) of this revenue procedure. That is, the appeals officer will disallow $1,000,000 of the deduction in each of 1997 and 1998. The taxpayer's basis in the property as of the beginning of 1998 is increased by $2,000,000 (representing the disallowance of the $1,000,000 of deductions in each of 1997 and 1998). Because the taxpayer's current method of accounting for the costs is not changed, the taxpayer is required to continue to deduct the costs not covered by the closing agreement (that is, the costs incurred in 1996, the remaining $1,000,000 of costs incurred in each of 1997 and 1998, and the costs incurred in 1999 and all subsequent taxable years). However, if the Service changes the taxpayer's method in 1999, the Service will compute a § 481(a) adjustment of $3,000,000 (including the $1,000,000 of the costs deducted in 1996 and the remaining $2,000,000 of the costs deducted in 1997 and 1998, because those costs are not items covered by the closing agreement). The Service also will disallow the deduction of $5,000,000 in 1999. The taxpayer's basis in the property as of the beginning of 1999 will be increased by an additional $8,000,000 (representing the $3,000,000 § 481(a) adjustment and the disallowance of the $5,000,000 deduction in 1999). The method change (once final) is effective for 1999. Thus, the taxpayer is required to capitalize the costs in 1999 and all subsequent taxable years, unless the taxpayer obtains the consent of the Commissioner to change the method or the Service changes the taxpayer from the method on subsequent examination.

Assuming, in the alternative, that the accounting method issue is resolved by providing in the closing agreement that, for the costs incurred in 1996 through 1998, the taxpayer will deduct 50% of the costs and capitalize the other 50% of the costs, and will increase taxable income by $500,000 in 1997 (representing the disallowance of $500,000 of costs in 1996). The appeals officer will disallow $1,000,000 of the deductions in each of 1997 and 1998. The taxpayer's basis in the property as of the beginning of 1998 is increased by $2,500,000 (representing the disallowance of the $500,000 of deductions in 1996 and the $1,000,000 of deductions in each of 1997 and 1998). The taxpayer's current method of accounting for the costs is not changed. Thus, the taxpayer is required to continue to deduct the costs not covered by the closing agreement (that is, the costs incurred in 1999 and all subsequent taxable years), unless the taxpayer obtains the consent of the Commissioner to change the method or the Service changes the taxpayer from the method on subsequent examination. If the Service changes the taxpayer's method in 1999, the Service will compute a § 481(a) adjustment of $0 (excluding the amount of the costs deducted in 1996 through 1998, because the manner in which those costs are to be accounted for is specifically covered by the closing agreement). The Service also will disallow the deduction of $5,000,000 in 1999. The taxpayer's basis in the property as of the beginning of 1999 will be increased by an additional $5,000,000 (representing the disallowance of the $5,000,000 deduction in 1999). The

method change (once final) is effective for 1999. Thus, the taxpayer is required to capitalize the costs in 1999 and all subsequent taxable years, unless the taxpayer obtains the consent of the Commissioner to change the method or the Service changes the taxpayer from the method on subsequent examination.

.04 *Appeals Resolution of Accounting Method Issue on Time-value-of-money Basis*.

(1) *Facts*. The facts are the same as section 10.02 of this revenue procedure, except that the appeals officer and the taxpayer agree to settle the issue on a time-value-of-money basis as described in section 6.02(4) of this revenue procedure. The taxpayer files its return on a calendar year basis. The appeals officer and the taxpayer agree to compute the specified amount using the sample computation described in section 6.02(4)(b)(ii) of the revenue procedure. The appeals officer believes that an appropriate factor to reflect the hazards of litigation is 25%. The taxpayer pays the specified amount on May 15, 2000. The highest marginal tax rate applicable to the taxpayer for 1997 and 1998 is 35% and the quarterly large corporation underpayment rates in effect for January 1, 1998, through June 30, 2000, are: 11%, 10%, 10%, 10%, 9%, 10%, 10%, 10%, 10%, and 11%. The specified amount under section 6.02(4) of this revenue procedure would be deductible under § 163(a) by the taxpayer if it were treated as interest expense arising from an underpayment of tax.

(2) *Computation of specified amount*. The hypothetical underpayment of tax for 1997 is $1,050,000, computed as follows: the net increase in taxable income of $3,000,000 (representing the § 481(a) adjustment of $1,000,000 and the disallowance of the deduction of $2,000,000 computed as if Examination had changed the taxpayer's method in 1997) multiplied by the applicable tax rate of 35%. The hypothetical underpayment of tax for 1998 is $700,000, computed as follows: the net increase in taxable income of $2,000,000 (representing the disallowance of the deduction of $2,000,000 computed as if Examination had changed the taxpayer's method in 1997) multiplied by the applicable tax rate of 35%.

The applicable time-value rate for 1997 is 6.565%, which is computed as follows: The applicable period for 1997 is March 15, 1998 (the due date of the return) to May 15, 2000 (the date the specified amount is paid). The underpayment rates in effect for the applicable period are 11%, 10%, 10%, 10%, 9%, 10%, 10%, 10%, 10%, and 11%. The average underpayment rate in effect for the applicable period is 10.1% [(11+10+10+10+9+10+10+10+10+11)/10]. The applicable after-tax time-value rate is 6.565%, computed by multiplying the average underpayment rate by one minus the applicable tax rate [10.1% * (1-.35)].

The applicable time-value rate for 1998 is 6.5%, which is computed as follows: The applicable period for 1998 is March 15, 1999 (the due date of the return) to May 15, 2000 (the date the specified amount is paid). The underpayment rates in effect for the applicable period are 9%, 10%, 10%, 10%, 10%, and 11%. The average underpayment rate in effect for the applicable period is 10.00% [(9+10+10+10+10+11)/6]. The applicable after-tax time-value rate is 6.5%, computed by multiplying the average underpayment rate by one minus the applicable tax rate [10.00% * (1-.35)].

The time-value-of-money benefit for each taxable year is computed by using the following formula:

$U * \{[1+(r/365)]^{n}-1\}$

where U = hypothetical underpayment for the taxable year
r = the applicable time-value rate
n = the number of days in the applicable period

The time-value-of-money benefit for 1997 is $160,519, computed as follows: $1,050,000 * $\{[1+(.06565/365)]^{791}-1$. The time-value-of-money benefit for 1998 is $55,165, computed as follows: $700,000 * $[1+(.065/365)]^{426}$ -1{ }.

The specified amount is the sum of the time-value-of-money benefit for 1997 and 1998 reduced by 25% to reflect the hazards of litigation. The specified amount is $161,763 computed as follows: ($160,519+$55,165)*(1-.25).

(3) *Effect*. The Service will not propose any adjustments to taxable income with respect to the taxpayer's method of accounting for the costs for 1997 and 1998. The taxpayer's basis in the property as of the beginning of 1998 is not changed. The taxpayer's current method of accounting for the costs is not changed. Thus, the taxpayer is required to continue to deduct the costs in 1999 and all subsequent taxable years, unless the taxpayer obtains the consent of the Commissioner to change the method or the Service changes the taxpayer from the method on subsequent examination. If the Service changes the taxpayer's method in 1999, the Service will compute a § 481(a) adjustment of $5,000,000 (representing the $1,000,000 of the costs deducted in 1996 and the $2,000,000 of costs deducted in each of 1997 and 1998). The Service will also disallow the deduction of $5,000,000 in 1999. The taxpayer's basis in the property as of the beginning of 1999 will be increased by $10,000,000 (representing the $5,000,000 § 481(a) adjustment and the disallowance of the $5,000,000 deduction in 1999). The method change (once final) is effective for 1999. Thus, the taxpayer is required to capitalize the costs in 1999 and all subsequent taxable years, unless the taxpayer obtains the consent of the Commissioner to change the method or the Service changes the taxpayer from the method on subsequent examination.

The interest on the taxpayer's deficiency (which reflects the inclusion of the $5,000,000 § 481(a) adjustment in taxable income) for 1999 is $100,000. A portion of the $100,000 of 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. The interest on the deficiency for 1999 includes the time-value-of-money benefit attributable to the § 481(a) adjustment for the period March 15, 2000, through the date of payment of the deficiency. The taxpayer previously paid the Service the time-value-of-money benefit attributable to $3,000,000 of the § 481(a) adjustment for the period March 15, 1998, through May 15, 2000, and $2,000,000 of disallowed deduction for the period March 15, 1999, through May 15, 2000. The interest on the deficiency for 1999 attributable to the overlap period of March 15, 2000, through May 15, 2000, is $19,112, computed as follows:

$A * t * \{[1+(r/365)]^{n}-1\}$

where A = the § 481(a) adjustment

t = highest marginal tax rate applicable to the taxpayer

r = the applicable time-value rate (computed for the overlap period)

n = the number of days in the overlap period

$\$5{,}000{,}000 * .35 * \{[1+(.065/365)]^{61}-1\}$

The $19,112 is reduced by 25% (the factor used by the appeals officer to reflect the hazards of litigation) to arrive at the interest credit of $14,334. The Service will treat the $14,334 as a payment toward the $100,000 of interest on the taxpayer's deficiency for 1999.

.05 *Default Procedures*.

(1) *Facts*. The facts are the same as section 10.01 of this revenue procedure, except that the examining agent does not provide the notice required by section 7.01 of this revenue procedure. Specifically, the examining agent disallows the deductions of $2,000,000 in each of 1997 and 1998, but does not compute the § 481(a) adjustment of $1,000,000 or otherwise provide notice that the accounting method issue is being treated as an accounting method change.

(2) *Effect*. The taxpayer's basis in the property as of the beginning of 1998 is increased by $4,000,000 (representing the disallowance of the $2,000,000 of deductions in each of 1997 and 1998). The taxpayer's current method of accounting for the costs is not changed. Thus, the taxpayer is required to continue to deduct the costs in 1999 and all subsequent taxable years, unless the taxpayer obtains the consent of the Commissioner to change the method or the Service changes the taxpayer from the method on subsequent examination. If the Service changes the taxpayer's method in 1999, the Service will compute a § 481(a) adjustment of $1,000,000 (representing the $1,000,000 of the costs deducted in 1996). The Service will also disallow the deduction of $5,000,000 in 1999. The taxpayer's basis in the property as of the beginning of 1999 will be increased by an additional $6,000,000 (representing the $1,000,000 § 481(a) adjustment and the disallowance of the $5,000,000 deduction in 1999). The method change (once final) is effective for 1999. Thus, the taxpayer is required to capitalize the costs in 1999 and all subsequent taxable years, unless the taxpayer obtains the consent of the Commissioner to change the method or the Service changes the taxpayer from the method on subsequent examination.

Assume that the examining agent disallows the deductions of $2,000,000 in each of 1997 and 1998 and computes the § 481(a) adjustment of $1,000,000, but does not label the § 481(a) adjustment or otherwise provide notice that the accounting method issue is being treated as an accounting method change. The taxpayer's basis in the property as of the beginning of 1998 is increased by $5,000,000 (representing the $1,000,000 adjustment and the disallowance of the $2,000,000 of deductions in each of 1997 and 1998). The taxpayer's current method of accounting for the costs is not changed. Thus, the taxpayer is required to continue to deduct the costs in 1999 and all subsequent taxable years, unless the taxpayer obtains the consent of the Commissioner to change the method or the Service changes the taxpayer from the method on subsequent examination. If the Service changes the taxpayer's method in 1999, the Service will compute a § 481(a) adjustment of $0 (excluding the $1,000,000 of the costs deducted in 1998 and the $2,000,000 of the costs deducted in each of 1997 and 1998 because the costs were accounted for in the prior adjustments). The Service will also disallow the deduction of $5,000,000 in 1999. The taxpayer's basis in the property as of the beginning of 1999 will be increased by an additional $5,000,000 (representing the disallowance of the $5,000,000 deduction in 1999). The method change (once final) is effective for 1999. Thus, the taxpayer is required to capitalize the costs in 1999 and all subsequent taxable years, unless the taxpayer obtains the consent of the Commissioner to change the method or the Service changes the taxpayer from the method on subsequent examination.

SECTION 11. EFFECTIVE DATE

.01 *In General*. Except as provided in section 11.02 of this revenue procedure, this revenue procedure is effective for:

(1) examiner's reports issued on or after July 1, 2002; and

(2) Forms 870AD and agreements executed on or after July 1, 2002 (regardless of when the underlying examiner's report was issued).

.02 *Transition Rule*. The Service and the taxpayer may agree to apply this revenue procedure to agreements executed on or after March 14, 2002.

DRAFTING INFORMATION

The principal author of this revenue procedure is Grant Anderson of the Office of Associate Chief Counsel (Income Tax and Accounting). For further information regarding this revenue procedure, contact Mr. Anderson at (202) 622–4970 (not a toll-free call).

APPENDIX A
MODEL CLOSING AGREEMENT FOR SETTLEMENT
ON ACCOUNTING METHOD CHANGE BASIS

Department of the Treasury Internal Revenue Service

Closing Agreement on Final Determination Covering Specific Matters

Under § 7121 of the Internal Revenue Code, [*Insert taxpayer's name, address, telephone number, and identifying number*] ("the taxpayer") and the Commissioner of Internal Revenue ("the Commissioner") make the following closing agreement:

WHEREAS:

1. The accounting method issue covered by this agreement is the taxpayer's method of accounting for [*identify subject: for example:* "credit sales"];

2. The taxable year(s) covered by this closing agreement are [*insert taxable year(s) covered by the agreement*];

3. The taxpayer and the Commissioner relied on the following facts and representations in making this closing agreement: [*insert any relevant facts*];

4. Under the taxpayer's present method of accounting for [*identify subject: for example*, "credit sales"], the taxpayer [*describe in detail the method of accounting being changed: for example*, "includes income from credit sales in gross income when payment is received"];

5. [*If applicable, insert:*] The taxpayer has filed an amended return(s) for the taxable year(s) ended [*insert applicable affected succeeding taxable year(s) for which a federal income tax return has been filed as of the date of the closing agreement*] to reflect the change in method of accounting for [*insert subject: for example*, "credit sales"] described in this closing agreement;

6. [*If applicable, insert:*] A stipulated decision has been entered by the [*insert name of federal court*] with respect to the taxable year(s) ended [*insert date(s)*] that reflects taxable income for such year(s) computed using the new method of accounting for [*insert subject: for example*, "credit sales"].

NOW IT IS HEREBY DETERMINED AND AGREED for federal income tax purposes that:

1. The Service is changing the taxpayer's method of accounting for [*insert subject: for example*, "credit sales"] to the method of [*describe the method of accounting to which the taxpayer is being changed: for example*, "including income from credit sales in gross income when all the events have occurred that fix the right to receive such income and the amount thereof can be determined with reasonable accuracy (an accrual method)"];

2. The change in method of accounting for [*insert subject: for example*, "credit sales"] is to be effected for the taxable year ended [*insert date*] (the year of change);

3. [*Insert if applicable*] An adjustment to income is required under § 481(a) of the Internal Revenue Code in the amount of $ [*insert amount in numbers*] ([*insert amount in words*] dollars), [*if applicable, insert* computed by taking into account the limitations under § 481(b),] as of the beginning of the year of change ([*insert date*]), for [*describe the adjustment: for example*, "credit sales"], which amount previously has not been included in the taxpayer's gross income. [*Alternatively, insert*] The change in method of accounting for [*insert subject: for example*, "credit sales"] is to made on a cut-off basis;

4. [*Insert if applicable*] The § 481(a) adjustment will be taken into account [*insert § 481(a) adjustment spread period: for example*, "entirely in the year of change."]

5. [*Insert if applicable*] The adjustment(s) to tax attributable to the adjustment(s) to taxable income resulting from the change in the method of accounting for [*insert subject: for example*, "credit sales"] (including the § 481(a) adjustment, current year adjustment(s), and any collateral adjustments to taxable income or tax liability resulting fom the change) for each taxable year covered by the closing agreement are as follows: [*insert the adjustments to each taxable year covered by the closing agreement in table form*], and;

6. The change in method of accounting for [*insert subject: for example*, "credit sales"] is a change in method of accounting within the meaning of Rev. Proc. 2002–18. As such, the provisions of section 446 of the Code, and the regulations thereunder, apply to the new method of accounting for [*insert subject: for example*, "credit sales."];

7. The Service is not precluded from changing the taxpayer's method of accounting for [*insert subject: for example*, "credit sales"] from the new method of accounting if the Service determines that the new method does not clearly reflect the taxpayer's income. However, under section 7.04(3) of Rev. Proc. 2002–18, the Service will not require the taxpayer to change its method of accounting for [*insert subject: for example*, "credit sales"] from the new method for [*insert taxable year(s) for which a federal income tax return has been filed as of the date of this closing agreement*], provided that:

(a) the taxpayer has complied with all the applicable provisions of this closing agreement;

(b) there has been no taxpayer fraud, malfeasance, or misrepresentation of a material fact;
(c) there has been no change in the material facts on which this closing agreement was based; and
(d) there has been no change in the applicable law on which this closing agreement was based;

8. [*Insert if applicable:*] The following additional conditions also apply: [*insert, for example, conditions with respect to waiving restrictions on assessment and collection, paying any tax, abating any overassessment, or refunding or crediting any tax overpayment*];

9. The taxpayer accepts this settlement and agrees to the applicable terms of Rev. Proc. 2002–18.

This agreement is final and conclusive except:

(1) The matter it relates to may be reopened in the event of fraud, malfeasance, or misrepresentation of a material fact;

(2) It is subject to the Internal Revenue Code sections that expressly provide that effect be given to their provisions (including any stated exception for § 7122) notwithstanding any law or rule of law; and

(3) If it relates to a tax period ending after the date of this agreement, it is subject to any law enacted after the agreement date, that applies to the tax period.

By signing, the parties certify that they have read and agreed to the terms of this document.

Your signature _____ **Date:** _____

Spouse's signature if joint return: _____ **Date:** _____

Taxpayer's representative: _____ Date: _____
Taxpayer (other than an individual): _____ Date: _____
Title: _____

Commissioner of Internal Revenue:
By:_____ Date:_____
Title:_____

Instructions

This agreement must be signed and filed in triplicate. (All copies must have original signatures.) The original and copies of the agreement must be identical. The name of the taxpayer must be stated accurately. The agreement may relate to one or more years.

If an attorney or agent signs the agreement for the taxpayer, the power of attorney (or a copy) authorizing that person to sign must be attached to the agreement.

If the taxpayer is a corporation, the agreement must be dated and signed with the name of the corporation, the signature and title of an authorized officer or officers, or the signature of an authorized attorney or agent. It is not necessary that a copy of an enabling corporate resolution be attached.

Use additional pages if necessary and identify them as part of this agreement.

Please see Rev. Proc. 68–16 (1968–1 C.B. 770) for a detailed description of practices and procedures applicable to most closing agreements.

APPENDIX B
MODEL CLOSING AGREEMENT FOR SETTLEMENT
ON NONACCOUNTING-METHOD-CHANGE BASIS

Department of the Treasury Internal Revenue Service

Closing Agreement on Final Determination Covering Specific Matters

Under § 7121 of the Internal Revenue Code, [*Insert taxpayer's name, address, telephone number, and identifying number*] ("the taxpayer") and the Commissioner of Internal Revenue ("the Commissioner") make the following closing agreement:

WHEREAS:

1. The accounting method issue covered by this closing agreement is [*identify subject: for example:* "costs of acquiring nondepreciable asset X"];

2. [*Insert if alternative-timing resolution*] The item(s) covered by this closing agreement are [*identify items subject to the closing agreement: for example*, "the costs incurred in connection with the acquisition of nondepreciable asset X in 1997 and 1998"]. [*Alternatively, insert if time-value-of-money resolution*] The taxable year(s) covered by this closing agreement are [*insert taxable year(s) covered by the agreement*];

3. The taxpayer and the Commissioner relied on the following facts and representations in making this closing agreement: [*insert any relevant facts*];

4. Under the taxpayer's present method of accounting for [*identify subject: for example*, "costs of acquiring nondepreciable asset X"], the taxpayer [*describe in detail the accounting method issue: for example*, "deducts the costs as an ordinary and necessary business expense"];

5. [*If applicable, insert:*] The taxpayer has filed an amended return(s) for the taxable year(s) ended [*insert applicable affected succeeding taxable years for which a federal income tax return has been filed as of the date of the closing agreement*] to reflect the alternative-timing resolution for [*insert subject: for example*, "costs of acquiring nondepreciable asset X"] described in this closing agreement;

6. [*If applicable, insert:*] A stipulated decision has been entered by the [*insert name of federal court*] with respect to the taxable years ended [*insert date(s)*] that reflects the nonaccounting-method-change resolution set forth in this agreement for [*insert subject: for example*, "costs of acquiring nondepreciable asset X"].

NOW IT IS HEREBY DETERMINED AND AGREED for federal income tax purposes that:

1. The Service is not changing the taxpayer's method of accounting for [*insert subject: for example*, "costs of acquiring nondepreciable asset X"].

2. The accounting method issue covered by this agreement (*[identify subject: for example:* "costs of acquiring nondepreciable asset X"]) is being resolved on [*insert basis for resolution: for example*, "an alternative-timing basis" or "a time-value-of-money basis"].

[*If alternative-timing resolution, insert the following paragraphs 3 – 9 as applicable*]

3. The items covered by the closing agreement are to be accounted for in the affected taxable years as follows: [*insert a description of the manner in which the items are to be accounted for, for example*, "Fifty percent of the costs incurred in each of 1997 and 1998 ($1,000,000) will be deductible and the remaining fifty percent ($1,000,000) will be capitalized"];

4. As a result of this treatment, [*Insert a description of any collateral effects of thie alternative-timing treatment: for example*, "the taxpayer's basis in asset X is increased by $2,000,000"];

5. Any items not specifically covered by this closing agreement are not affected by this agreement;

6. The adjustment(s) to tax attributable to the adjustment to taxable income resulting from the resolution of [*insert subject: for example*, "costs of acquiring nondepreciable asset X"] by this agreement (including the current year adjustment and any collateral adjustments for each taxable year affected by this closing agreement) is [*insert taxable year(s)*], $ [*insert amount in numbers] ([insert amount in words*] dollars);

7. The Service is not precluded from changing the taxpayer's method of accounting for [*insert subject: for example*, "costs of acquiring nondepreciable asset X"] upon subsequent examination for any open taxable year for items not covered by this agreement;

8. If the taxpayer's method of accounting for [*insert subject: for example*, "costs of acquiring nondepreciable asset X"] subsequently is changed (voluntarily or involuntarily) in any open taxable year, the adjustment under § 481(a) (if any) will be determined by reference to all items arising prior to the year of change except for those items specifically covered by this closing agreement; and

9. [*Insert if applicable:*] The following additional conditions also apply: [*insert, for example, conditions with respect to waiving restrictions on assessment and collection, paying any tax, abating any overassessment, or refunding or crediting any tax overpayment*];

[*Alternatively, if a time-value-of-money resolution, insert the following paragraphs 3 – 10 as applicable*]

3. The computation of the specified amount as provided in section 6.02(4)(b) of Rev. Proc. 2002–18 has been made as follows: [*insert computation*].

4. The specified amount is not interest under § 163(a) of the Code and may not be deducted or capitalized under any provision of the Code.

5. [*Insert if the computation of the specified amount takes into account the taxpayer's actual tax attributes*] The tax attributes that may affect the computation of the taxpayer's tax liability in subsequent taxable years [*insert* "are" *or* "are not"] adjusted to reflect their effect on the specified amount;

6. The Service is not precluded from changing the taxpayer's method of accounting for [*insert subject: for example*, "costs of acquiring nondepreciable asset X"] upon subsequent examination for any open taxable year not covered by the agreement;

8. If the taxpayer's method of accounting for [*insert subject: for example*, "costs of acquiring nondepreciable asset X"] subsequently is changed (voluntarily or involuntarily) in any open taxable year not covered by this agreement, the adjustment under § 481(a) (if any) will be determined by reference to all items arising prior to the year of change;

9. If the Service changes the taxpayer's method of accounting in an open taxable year not covered by this agreement and imposes a § 481(a) adjustment, the interest that is assessed on any underpayment, or the interest that is due on any overpayment, for the year of change 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;

10. [*Insert if applicable:*] The following additional conditions also apply: [*insert, for example, conditions with respect to waiving restrictions on assessment and collection, paying any tax, abating any overassessment, or refunding or crediting any tax overpayment*];

The taxpayer accepts this settlement and agrees to the applicable terms of Rev. Proc. 2002–18.

This agreement is final and conclusive except:

(1) The matter it relates to may be reopened in the event of fraud, malfeasance, or misrepresentation of a material fact;

(2) It is subject to the Internal Revenue Code sections that expressly provide that effect be given to their provisions (including any stated exception for § 7122) notwithstanding any law or rule of law; and

(3) If it relates to a tax period ending after the date of this agreement, it is subject to any law enacted after the agreement date, that applies to the tax period.

By signing, the parties certify that they have read and agreed to the terms of this document.

Your signature_____ Date:_____
Spouse's signature if joint return: _____ Date:_____
Taxpayer's representative: _____ Date:_____
Taxpayer (other than an individual): _____ Date:_____
Title:_____

Commissioner of Internal Revenue:

By:_____ Date:_____
Title:_____

Instructions

This agreement must be signed and filed in triplicate. (All copies must have original signatures.) The original and copies of the agreement must be identical. The name of the taxpayer must be stated accurately. The agreement may relate to one or more years.

If an attorney or agent signs the agreement for the taxpayer, the power of attorney (or a copy) authorizing that person to sign must be attached to the agreement.

If the taxpayer is a corporation, the agreement must be dated and signed with the name of the corporation, the signature and title of an authorized officer or officers, or the signature of an authorized attorney or agent. It is not necessary that a copy of an enabling corporate resolution be attached.

Use additional pages if necessary and identify them as part of this agreement.

Please see Rev. Proc. 68–16 (1968–1 C.B. 770) for a detailed description of practices and procedures applicable to most closing agreements.

26 CFR 601.204: Changes in accounting periods and methods of accounting.
(Also Part I, §§ 446, 481; 1.446–1, 1.481–1, 1.481–4.)

Rev. Proc. 2002–19

SECTION 1. PURPOSE

This revenue procedure modifies Rev. Proc. 97–27 (1997–1 C.B. 680) which provides procedures under which taxpayers may obtain the advance consent of the Commissioner of Internal Revenue to change a method of accounting. In addition, this revenue procedure modifies Rev. Proc. 2002–9 (2002–3 I.R.B. 327) which provides procedures for taxpayers within the scope of that revenue procedure to obtain automatic consent to change a method of accounting.

The changes to Rev. Proc. 97–27 and Rev. Proc. 2002–9 include:

(1) allowing a taxpayer to change its method of accounting prospectively, without audit protection, if the method to be changed is an issue pending for a taxable year under examination or an issue under consideration by either an appeals office or a federal court;

(2) providing that, in the case of changes in method of accounting that result in a negative (*i.e.*, taxpayer-favorable) § 481(a) adjustment, the entire amount of the adjustment will be taken into account in the year of change; and

(3) certain other conforming and clarifying changes.

For a discussion of the policy reasons for certain of the modifications provided by this revenue procedure, see Announcement 2002–37 (2002–13 I.R.B. 703)

SECTION 2. CHANGES

.01 *Changes to BACKGROUND Sections*. Section 2.01(3) in each of Rev. Proc. 97–27 and Rev. Proc. 2002–9 is deleted.

.02 *Changes to § 481(a) Spread Period for Negative § 481(a) Adjustments.*

(1) Section 5.02(3)(a) of Rev. Proc. 97–27 is modified to read as follows:

"(a) *In general*. Except as otherwise provided in sections 5.02(3)(b) and 7.03 of this revenue procedure, the § 481(a) adjustment period is four taxable years for a net positive adjustment for an accounting method change, and one taxable year for a net negative adjustment for an accounting method change."

(2) Section 5.04(1) of Rev. Proc. 2002–9 is modified to read as follows:

"(1) *In general*. Except as otherwise provided in section 5.04(3) or the APPENDIX of this revenue procedure, the § 481(a) adjustment period is four taxable years for a net positive adjustment for an accounting method change, and one taxable year for a net negative adjustment for an accounting method change."

(3) The second sentence in both Example 1 and Example 2 in section 7.02 of Rev. Proc. 97–27 and section 5.04(2) of Rev. Proc. 2002–9 is modified to read as follows:

"The net § 481(a) adjustment for this method change is a positive adjustment of $30,000 and the adjustment period is four taxable years."

(4) Section 7.03(1) of Rev. Proc. 97–27 and section 5.04(3)(a) of Rev. Proc. 2002–9 are each modified to read as follows:

"*De minimis* rule. A taxpayer may elect to use a one-year adjustment period in lieu of the § 481(a) adjustment period otherwise provided by this revenue procedure for positive adjustments if the net § 481(a) adjustment for the change is less than $25,000. The taxpayer must complete the appropriate line on the Form 3115 to elect this *de minimis* rule."

(5) Section 4.01(3) of the APPENDIX of Rev. Proc. 2002–9 (relating to the § 481(a) adjustment for certain uniform capitalization methods used by resellers and reseller-producers) is modified to read as follows:

"(3) *Section 481(a) adjustment*. Beginning with the year of change, a taxpayer changing its method of accounting for costs pursuant to sections 4.01(a)(1)(i), 4.01(1)(a)(iii), or 4.01(1)(a)(iv) of this APPENDIX generally must take any applicable net positive § 481(a) adjustment for such change into account ratably over the same number of taxable years, not to exceed four, that the taxpayer used its former method of accounting. A taxpayer changing its method of accounting for costs pursuant to sections 4.01(1)(a)(ii), 4.01(1)(a)(v), or 4.01(1)(a)(vi) of this APPENDIX generally must take any applicable net positive § adjustment for such change into account ratably over four taxable years. See section 5.04(3) of this revenue procedure for exceptions to this general rule."

(6) Section 4.01(5) of the APPENDIX of Rev. Proc. 2002–9, which provides an example illustrating the change to and from a UNICAP method of accounting for small resellers and formerly small resellers is modified to read as follows:

"(5) *Example*.

* * *

Because X satisfies the small reseller exception for 1997, X may change voluntarily from the UNICAP method to a permissible non-UNICAP inventory capitalization method under section 4.01 of this APPENDIX. To reflect the removal of the additional § 263A costs from the cost of its 1997 beginning inventory, X must compute a corresponding § 481(a) adjustment, which is a negative $100,000 ($1,200,000 - $1,300,000). The entire amount of this negative § 481(a) adjustment is included in the computation of X's taxable income for 1997. In addition, X must include $20,000 of the unamortized 1995 § 481(a) adjustment in 1997 taxable income.

X's 1997 Ending Inventory:	
Beginning Inventory (With UNICAP costs)	$1,300,000
1997 Increment	100,000
1997 § 481(a) Adjustment <Negative>	<100,000>
Total 1997 Ending Inventory	$1,300,000

X's Unamortized 1995 § 481(a) Adjustment:

Unamortized 1995 § 481(a) Adjustment—12/31/96	$40,000
Amount Included in 1997 Taxable Income	<20,000>
Unamortized 1995 § 481(a) Adjustment—12/31/97	$20,000

X's Unamortized 1997 § 481(a) Adjustment:

1997 § 481(a) Adjustment <Negative>	$<100,000>
Amount Included in 1997 Taxable Income	100,000
Unamortized 1997 § 481(a) Adjustment—12/31/97	$ 0

X also satisfies the small reseller exception for 1998 and, therefore, is not required to return to the UNICAP method for 1998. X, however, must include $20,000 of the unamortized 1995 positive § 481(a) adjustment in its 1998 taxable income.

X's 1998 Ending Inventory:

Beginning Inventory (Without UNICAP costs)	$1,300,000
1998 Increment	100,000
Total 1998 Ending Inventory	$1,400,000

X's Unamortized 1995 § 481(a) Adjustment:

Unamortized 1995 § 481(a) Adjustment—12/31/97	$20,000
Amount Included in 1998 Taxable Income	<20,000>
Unamortized 1995 § 481(a) Adjustment—12/31/98	$ 0

In 1999, X fails to satisfy the small reseller exception and, therefore, must return to the UNICAP method as provided under section 4.01 of this APPENDIX. X changes to the simplified resale method without a historic absorption ratio election under § 1.263A–3(d)(3). Assume that X must capitalize $120,000 of additional § 263A costs to the cost of its 1999 beginning inventory because of this change in inventory method. Because X used a non-UNICAP for two taxable years prior to 1999, the § 481 spread period for the positive § 481(a) adjustment is two years. Therefore, X must include one-half of the § 481(a) adjustment ($60,000) when computing taxable income for 1999 and 2000. Assume that X must add $10,000 of additional § 263A costs to the cost of its 1999 ending inventory because of the $100,000 increment for 1999.

X's 1999 Ending Inventory:

Beginning Inventory (Without UNICAP costs)	$1,400,000
1999 Increment	100,000
Additional § 263A costs in Beginning Inventory	120,000
Additional § 263A costs in 1999 Increment	10,000
Total 1999 Ending Inventory	$1,630,000

X's Unamortized 1999 § 481(a) adjustment:

1999 § 481(a) Adjustment	$120,000
Amount Included in 1999 Taxable Income	<60,000>
Unamortized 1999 § 481(a) Adjustment—12/31/99	$60,000

Because X fails to satisfy the small reseller exception for 2000, X must continue using the UNICAP method for its inventory costs. Furthermore, X is required to include $60,000 of the unamortized 1999 positive § 481(a) adjustment in 2000 taxable income. Assume that X is required to add $10,000 of additional § 263A costs to the cost of its 2000 ending inventory because of the $100,000 increment for 2000.

X's 2000 Ending Inventory:

Beginning Inventory (With UNICAP costs)	$1,630,000
2000 Increment	100,000
Additional § 263A Costs in 2000 Increment	10,000
Total 2000 Ending Inventory	$1,740,000

X's Unamortized 1999 § 481(a) Adjustment:

Unamortized 1999 § 481(a) Adjustment—12/31/99	$60,000
Amount Included in 2000 Taxable Income	<60,000>
Unamortized 1999 § 481(a) Adjustment—12/31/00	$ 0

.03 *Changes to Scope Restrictions for Taxpayers Under Examination, or Before an Area Appeals Office or a Federal Court.*

(1) *Taxpayers under examination.*

(a) Section 4.02(2) of Rev. Proc. 97–27 (relating to the situations in which Rev. Proc. 97–27 does not apply) is modified to read as follows:

"(2) *Under examination.* If the taxpayer is under examination, except as provided in sections 6.01(2) (90-day window), 6.01(3) (120-day window), 6.01(4) (director consent), and 6.01(5) (issue pending) of this revenue procedure."

(b) Section 6.01 of Rev. Proc. 97–27 (relating to procedures for taxpayers under examination) is modified as follows:

"(1) *In general.* A taxpayer that is under examination may not file a Form 3115 to request a change in accounting method under this revenue procedure except as provided in sections 6.01(2) (90-day window), 6.01(3) (120-day window), 6.01(4) (director consent), and 6.01(5) (issue pending). A taxpayer that files a Form 3115 beyond the time periods provided in the 90-day and 120-day windows will not be granted an extension of time to file under § 301.9100, except in unusual and compelling circumstances."

* * *

"(5) *Issue Pending.* (a) A taxpayer that is under examination with respect to any income tax issue may request to change a method of accounting if the method of accounting to be changed is an issue pending for any taxable year under examination. However, the audit protection provisions of section 9.01 of this revenue procedure do not apply to a taxpayer changing its method of accounting under this section 6.01(5). For this purpose, an issue is pending for taxable years under examination if the Service 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. This notification normally will occur after the Service has gathered information sufficient to determine that an adjustment is appropriate and justified, although the exact amount of the adjustment may not yet be determined.

(b) A taxpayer that requests to change a method of accounting under this section 6.01(5) must provide a copy of the Form 3115 to the examining agent(s) at the same time it files the original Form 3115 with the national office. The Form 3115 must contain the name(s) and telephone number(s) of the examining agent(s). In order to assist in processing an application under this section 6.01(5), the taxpayer should type or legibly write "Issue pending" on the Form 3115."

(c) Section 4.02(1) of Rev. Proc. 2002–9 (relating to situations in which Rev. Proc. 2002–9 does not apply) is modified to read as follows:

"(1) *Under examination.* If, on the date the taxpayer would otherwise file a copy of the application with the national office, the taxpayer is under examination (as provided in section 3.08 of this revenue procedure), except as provided in sections 6.03(2) (90-day window), 6.03(3) (120-day window), 6.03(4) (director consent), 6.03(5) (changes lacking audit protection), and 6.03(6) (issue pending) of this revenue procedure."

(d) Section 6.03 of Rev. Proc. 2002–9 (relating to procedures for taxpayers under examination) is modified as follows:

"(1) *In general.* Except as otherwise provided in the APPENDIX of this revenue procedure (see, for example, section 1.01 of the APPENDIX of this revenue procedure), a taxpayer that is under examination may file an application to change a method of accounting under section 6 of this revenue procedure only if the taxpayer is within the provisions of section 6.03(2) (90-day window), 6.03(3) (120-day window), 6.03(4) (director consent), 6.03(5) (changes lacking audit protection), or 6.03(6) (issue pending) of this revenue procedure. A taxpayer that files an application beyond the time periods provided in the 90-day and 120-day windows is not eligible for the automatic extension of time and will not be granted an extension of time to file under § 301.9100, except in unusual and compelling circumstances."

* * *

"(6) *Issue Pending*. (a) A taxpayer that is under examination with respect to any income tax issue may request to change a method of accounting if the method of accounting to be changed is an issue pending for any taxable year under examination. However, the audit protection provisions of section 7.01 of this revenue procedure do not apply to a taxpayer changing its method of accounting under this section 6.03(6). For this purpose, an issue is pending for taxable years under examination if the Service 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. This notification normally will occur after the Service has gathered information sufficient to determine that an adjustment is appropriate and justified, although the exact amount of the adjustment may not yet be determined.

(b) A taxpayer that requests to change a method of accounting under this section 6.03(6) must provide a copy of the Form 3115 to the examining agent(s) at the same time it files the original Form 3115 with the national office. The Form 3115 must contain the name(s) and telephone number(s) of the examining agent(s). In order to assist in processing an application under this section 6.03(6), the taxpayer should type or legibly write "Issue pending" on the Form 3115."

(2) *Taxpayers before an appeals office*.

(a) Section 4.02(3) of Rev. Proc. 97–27 (relating to the situations in which Rev. Proc. 97–27 does not apply) is deleted.

(b) Section 6.02 of Rev. Proc. 97–27 (relating to procedures for taxpayers before an appeals office) is modified as follows:

".02 *Taxpayer before an appeals office*. A taxpayer otherwise within the scope of this revenue procedure that is before an appeals office with respect to any income tax issue may request a change in accounting method. However, the audit protection provisions of section 9.01 of this revenue procedure do not apply if the accounting method to be changed is an issue under consideration by the appeals office. A taxpayer that requests to change a method of accounting under this section 6.02 must provide a copy of the Form 3115 to the appeals officer at the time it files the original Form 3115 with the national office. The Form 3115 must contain the name(s) and telephone number(s) of the appeals officer(s). In order to assist in processing an application under this section 6.02, the taxpayer should type or legibly write "Issue under consideration" on the Form 3115."

(c) Section 4.02(2) of Rev. Proc. 2002–9 (relating to situations to which Rev. Proc. 2002–9 does not apply) is deleted.

(d) Section 6.04 of Rev. Proc. 2002–9 (relating to procedures for taxpayers before an appeals office) is modified to read as follows:

".04 *Taxpayer before an appeals office*. A taxpayer otherwise within the scope of this revenue procedure that is before an appeals office with respect to any income tax issue may request a change in accounting method. However, the audit protection provisions of section 7.01 of this revenue procedure do not apply if the accounting method to be changed is an issue under consideration by the appeals office. A taxpayer that requests to change a method of accounting under this section 6.04 must provide a copy of the Form 3115 to the appeals officer at the time it files the original Form 3115 with the national office. The Form 3115 must contain the name(s) and telephone number(s) of the appeals officer(s). In order to assist in processing an application under this section 6.04, the taxpayer should type or legibly write "Issue under consideration" on the Form 3115."

(3) *Taxpayers before a federal court*.

(a) Section 4.02(4) of Rev. Proc. 97–27 (relating to the situations in which Rev. Proc. 97–27 does not apply) is deleted.

(b) Section 6.03 of Rev. Proc. 97–27 (relating to procedures for taxpayers before a federal court) is modified to read as follows:

".03 *Taxpayer before a federal court*. A taxpayer otherwise within the scope of this revenue procedure that is before a federal court with respect to any income tax issue may request a change in accounting method. However, the audit protection provisions of section 9.01 of this revenue procedure do not apply if the accounting method to be changed is an issue under consideration by the federal court. A taxpayer that requests to change a method of accounting under this section 6.03 must provide a copy of the Form 3115 to the counsel(s) for the government at the time it files the original Form 3115 with the national office. The Form 3115 must contain the name(s) and telephone number(s) of the counsel(s) for the government. In order to assist in processing an application under this section 6.03, the taxpayer should type or legibly write "Issue under consideration" on the Form 3115."

(c) Section 4.02(3) of Rev. Proc. 2002–9 (relating to situations to which Rev. Proc. 2002–9 does not apply) is deleted.

(d) Section 6.05 of Rev. Proc. 2002–9 (relating to procedures for taxpayers before a federal court) is modified to read as follows:

.05 *Taxpayer before a federal court*. A taxpayer otherwise within the scope of this revenue procedure that is before a federal court with respect to any income tax issue may request a change in accounting method. However, the audit protection provisions of section 7.01 of this revenue procedure do not apply if the accounting method to be changed is an issue under consideration by the federal court. A taxpayer that requests to change a method of accounting under this section 6.05 must provide a copy of the Form 3115 to the counsel(s) for the government at the time it files the original Form 3115 with the national office. The Form 3115 must contain the name(s) and telephone number(s) of the counsel(s) for the government. In order to assist in processing an application under this section 6.05, the taxpayer should type or legibly write "Issue under consideration" on the Form 3115."

.04 *Notional Principal Contracts*. Section 14.02 of Rev. Proc. 97–27 (relating to Designated A treatment for changes in method of accounting for notional principal contracts) is deleted.

SECTION 3. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 97–27 and Rev. Proc. 2002–9 are modified and amplified.

SECTION 4. EFFECTIVE DATE

.01 *In General*. Except as otherwise provided in sections 4.02 and 4.03 of this revenue procedure, this revenue procedure is effective for taxable years ending on or after December 31, 2001.

.02 *Changes to Scope Restrictions of Rev. Proc. 97–27*. Notwithstanding section 4.01 of this revenue procedure, the changes to the scope restrictions of Rev. Proc. 97–27 provided in section 2.03(1)(a) and (b), 2.03(2)(a) and (b), and 2.03(3)(a) and (b) of this revenue procedure are effective for taxable years ending on or after March 14, 2002.

.03 *Notional Principal Contracts*. Notwithstanding section 4.01 of this revenue procedure, the deletion of section 14.02 of Rev. Proc. 97–27 is effective for Forms 3115 pending with the national office on March 14, 2002.

.04 *Transition Rules*.

(1) *Applications Under Rev. Proc. 2002–9*.

(a) If a taxpayer has filed its federal income tax return on or before April 15, 2002, for a taxable year ending on or after December 31, 2001, and wants to change a method of accounting for such taxable year under Rev. Proc. 2002–9 for an issue pending at examination, or an issue under consideration by an area office or by a federal court, without audit protection, as permitted under this revenue procedure, then the taxpayer must comply with the requirements of this section 4.04(1)(a). The taxpayer must complete and file a Form 3115 in duplicate. The original must be attached to the taxpayer's amended federal income tax return for the year of change. The amended return must be filed no later than September 10, 2002. A copy of the Form 3115 must be filed with the national office (see section 6.02(6) of Rev. Proc. 2002–9 for the address) no later than when the taxpayer's amended return is filed.

(b) If a taxpayer has applied to change a method of accounting under Rev. Proc. 2002–9 for a taxable year ending on or after December 31, 2001, by filing an application with its federal income tax return on or before April 15, 2002, such change in method of accounting results in a net negative § 481(a) adjustment, and the taxpayer wants to apply the one-year § 481(a) adjustment period of this revenue procedure to the change, then the taxpayer must comply with the requirements of this section 4.04(1)(b). The taxpayer must complete and file a revised Form 3115 in duplicate, reflecting the one-year § 481(a) adjustment period. The original must be attached to the taxpayer's amended federal income tax return for the year of change. The amended return must be filed no later than September 10, 2002. A copy of the revised Form 3115 must be filed with the national office (see section 6.02(6) of Rev. Proc. 2002–9 for the address) no later than when the taxpayer's amended return is filed. Both the original and the copy of the application filed with the national office should be labeled "Substitute Application under Rev. Proc. 2002–19."

(c) If a taxpayer has filed a copy of an application to change a method of accounting under Rev. Proc. 2002–9 for a taxable year ending on or after December 31, 2001, with the national office on or before April 15, 2002, but has not filed its federal income tax return with the original application attached by April 15, 2002, such change in method of accounting results in a net negative § 481(a) adjustment, and the taxpayer wants to apply the one-year § 481(a) adjustment period of this revenue procedure to the change, then the taxpayer must comply with the requirements of this section 4.04(1)(c). The taxpayer must complete and file a revised Form 3115 in duplicate, reflecting the one-year § 481(a) adjustment period. The revised original Form 3115 must be attached to the taxpayer's timely filed federal income tax return for the year of change. The revised copy of the Form 3115 must be filed with the national office (see section 6.02(6) of Rev. Proc. 2002–9 for the address) no later than when the taxpayer's original federal income tax return is filed. The copy of the application filed with the national office should be labeled "Substitute Application under Rev. Proc. 2002–19."

(d) If a taxpayer has filed an original application and/or a copy of an application to change a method of accounting under Rev. Proc. 2002–9 for a taxable year ending on or after December 31, 2001, with the national office on or before April 15, 2002, such change in method of accounting results in a net negative § 481(a) adjustment, and the taxpayer does not file revised applications under either section 4.04(1)(b) or (c) of this revenue procedure (whichever applies), then the four-year § 481(a) adjustment period of Rev. Proc. 2002–9 (prior to its modification by this revenue procedure) will apply to the change.

(2) *Applications Under Rev. Proc. 97–27*. In the case of an application to change a method of accounting for a taxable year ending on or after December 31, 2001, filed under Rev. Proc. 97–27, and pending with the national office on March 14, 2002, the § 481(a) adjustment period for a net negative § 481(a) adjustment for the change will be one taxable year. In such a case, the national office will require the taxpayer to make appropriate modifications to the application or ruling request to comply with the applicable provisions of this revenue procedure. However, if such a taxpayer does not want a one-year § 481(a) adjustment period to apply, the taxpayer must notify the national office prior to the later of April 30, 2002, or the issuance of the letter ruling granting or denying consent to the change. In such a case, the § 481(a) adjustment period rules of Rev. Proc. 97–27, prior to its modification by this revenue procedure, will apply.

DRAFTING INFORMATION

The principal author of this revenue procedure is Grant D. Anderson of the Office of Associate Chief Counsel (Income Tax and Accounting). For further information concerning this revenue procedure, please contact Mr. Anderson at (202) 622–4970 (not a toll-free call).

Part IV. Items of General Interest

Notice of Proposed Rulemaking by Cross-Reference to Temporary Regulations and Notice of Public Hearing

Loss Limitation Rules

REG–102740–02

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking by cross-reference to temporary regulations and notice of public hearing.

SUMMARY: This document contains proposed regulations under sections 337(d) and 1502 of the Internal Revenue Code. These regulations permit certain losses recognized on sales of subsidiary stock by members of a consolidated group. The regulations apply to corporations filing consolidated returns, both during and after the period of affiliation, and also affect purchasers of the stock of members of a consolidated group. The text of the temporary regulations published in T.D. 8984, in this issue of the Bulletin also serves as the text of these proposed regulations. This document also provides notice of a public hearing on these proposed regulations.

DATES: Written or electronic comments must be received by July 10, 2002. Requests to speak (with outlines of oral comments to be discussed) at the public hearing scheduled for July 17, 2002, at 10 a.m., must be received by June 26, 2002.

ADDRESSES: Send submissions to: CC:ITA:RU (REG–102740–02), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 6 p.m. to CC:ITA:RU (REG–102740–02), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. Alternatively, taxpayers may submit electronic comments directly to the IRS Internet site at *www.irs.gov/regs*. The public hearing will be held in the Internal Revenue Service Auditorium, in the Internal Revenue Service Building, 1111 Constitution Avenue, NW, Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Sean P. Duffley (202) 622–7530, or Lola L. Johnson (202) 622–7550; concerning submissions of comments, the hearing, and/or to be placed on the building access list to attend the hearing, LaNita VanDyke (202) 622–7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information in this notice of proposed rulemaking has been submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)). Comments on the collection of information should be sent to the Office of Management and Budget, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the **Internal Revenue Service**, Attn: IRS Reports Clearance Officer, W:CAR:MP:FP:S, Washington, DC 20224. Comments on the collection of information should be received by May 6, 2002. Comments are specifically requested concerning:

Whether the proposed collection of information is necessary for the proper performance of the functions of the Internal Revenue Service, including whether the information will have practical utility;

The accuracy of the estimated burden associated with the proposed collection of information (see below);

How the quality, utility, and clarity of the information to be collected may be enhanced;

How the burden of complying with the proposed collection of information may be minimized, including through the application of automated collection techniques or other forms of information technology; and

Estimates of capital or start up-costs and the costs of operation, maintenance, and purchase of services to provide information.

The collection of information in this proposed regulation is in §§ 1.337(d)–2T, 1.1502–20T, and 1.1502–32T. The collection of information is required to allow the taxpayer to make certain elections to determine the amount of allowable loss under § 1.337(d)–2T, § 1.1502–20 as currently in effect, or under § 1.1502–20 modified so that the amount of allowable loss determined pursuant to § 1.1502–20(c)(1) is computed by taking into account only the amounts computed under § 1.1502–20(c)(1)(i) and (ii); to allow the taxpayer to reapportion a section 382 limitation in certain cases; to allow the taxpayer to waive certain loss carryovers; and to ensure that loss is not disallowed under § 1.337(d)–2T and basis is not reduced under § 1.337(d)–2T to the extent the taxpayer establishes that the loss or basis is not attributable to the recognition of built-in gain on the disposition of an asset. The collection of information is required to obtain a benefit. The likely respondents are corporations that file consolidated income tax returns.

Estimated total annual reporting burden: 30,000 hours.

Estimated average annual burden hours per respondent: 2 hours.

Estimated number of respondents: 15,000.

Estimated annual frequency of responses: once.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number assigned by the Office of Management and Budget.

Books or records relating to the collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Background

Temporary regulations in this issue of the Bulletin amend the Income Tax Regulations (26 CFR part 1) relating to sections 337(d) and 1502. The text of those regulations also serves as the text of these proposed regulations. The preamble to the

temporary regulations contains a full explanation of the reasons underlying the issuance of the proposed regulations.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It is hereby certified that these regulations do not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that these regulations will primarily affect affiliated groups of corporations that have elected to file consolidated returns, which tend to be larger businesses, and, moreover, that any burden on taxpayers is minimal. Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Internal Revenue Code, these regulations will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

Comments and Public Hearing

The IRS and Treasury are undertaking a study of the various approaches that could be implemented to give full effect to section 337(d) and to reflect the single entity principles of the consolidated return rules. Among the approaches the IRS and Treasury are studying is one that would deny positive investment adjustments for gain recognized and income attributable to the disposition or consumption of built-in gain assets held by the subsidiary at the time it joined the consolidated group. In addition, the IRS and Treasury are considering allowing selling groups to deduct subsidiary stock losses that would otherwise reflect duplicated loss, if the subsidiary reduces its attributes (including net operating loss carryovers and asset basis) immediately prior to the disposition. Comments are requested concerning any approaches that may be employed to allow appropriate losses in a manner that is administrable for both taxpayers and the government.

Before these proposed regulations are adopted as final regulations, consideration will be given to any electronic and written comments (a signed original and eight (8) copies) that are submitted timely to the IRS. All comments will be available for public inspection and copying. A public hearing has been scheduled for July 17, 2002, at 10 a.m., in the IRS Auditorium, IRS Building, 1111 Constitution, NW, Washington, DC. Because of access restrictions, visitors will not be admitted beyond the building lobby more than 15 minutes before the hearing starts.

Drafting Information

The principal authors of these regulations are Sean P. Duffley and Lola L. Johnson, Office of Associate Chief Counsel (Corporate). However, other personnel from the IRS and Treasury participated in their development.

Proposed Amendments to the Regulations

Accordingly, 26 CFR parts 1 and 602 are proposed to be amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 1.337(d)–2 is added to read as follows:

§ 1.337(d)–2 Loss limitation window period.

[The text of this proposed section is the same as the text of § 1.337(d)–2T published elsewhere in this issue of the **Federal Register**].

Par. 3. In § 1.1502–20, paragraph (i) is added to read as follows:

§ 1.1502–20 Disposition or deconsolidation of subsidiary stock.

[The text of this proposed section is the same as the text of § 1.1502–20T(i) published elsewhere in this issue of the **Federal Register**].

Par. 4. In § 1.1502–32, paragraph (b)(4)(v) is added to read as follows:

§ 1.1502–32 Investment adjustment.

[The text of this proposed section is the same as the text of § 1.1502–32T(b)(4)(v) published elsewhere in this issue of the **Federal Register**].

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on March 7, 2002, 3:17 p.m., and published in the issue of the Federal Register for March 12, 2002, 67 F.R. 11070)

Extension of Time to File Form(s) 1042–S

Announcement 2002–34

The IRS has received inquiries regarding the implementation of the new withholding and reporting requirements under §§ 1.1441 and 1.1461 of the Income Tax Regulations (T.D. 8734, 1997–2 C.B. 109 and T.D. 8881, 2000–23 I.R.B. 1158). Specifically, the IRS has recently become aware that some taxpayers (including, in particular, small taxpayers) are experiencing difficulty implementing the changes to the Form 1042–S reporting requirements (which require the filing of information returns to report certain payments to nonresident aliens). Under the regulations, a withholding agent must file Form(s) 1042–S with the IRS on or before March 15 of the calendar year following the year in which the amount subject to reporting was paid. See § 1.1461–1(c).

The IRS believes that ensuring the successful implementation of these new withholding and reporting procedures is in the best interests of sound tax administration. Accordingly, the IRS is extending the due date for filing 2001 Forms 1042–S from March 15, 2002, to May 15, 2002.

The principal author of this announcement is Laurie Hatten-Boyd of the Office of Associate Chief Counsel (International). For further information regarding this announcement, contact Ms. Hatten-Boyd at (202) 622–3840 (not a toll-free call).

Extension of Comment Period on White Paper on Future of Employee Plans Determination Letter Program

Announcement 2002–36

The Service is extending the comment period on its white paper on the long-term future of the Employee Plans (EP) determination letter program.

In Announcement 2001–83 (2001–35 I.R.B. 205), the Service invited the public to participate in a dialogue on the future of the EP determination letter program by submitting comments on a white paper that it had published on the Internet in August 2001. The white paper is entitled *The Future of the Employee Plans Determination Letter Program: Some Possible Options* and it may be downloaded from the Internet at the following site: *http://www.irs.gov/ep*. Announcement 2001–83 asked for written comments on the white paper to be submitted by March 31, 2002.

In order to provide an opportunity to those who wish to comment but are unable to do so by March 31, 2002, the Service is extending the comment period under Announcement 2001–83 to July 1, 2002. Commentators are also asked to comment on whether the Service should hold a series of nationwide town meetings to permit furtherance of dialogue on the future of the EP determination letter program. Comments should be submitted in duplicate and reference Announcement 2001–83. Comments should be sent to the following address:

CC:M&SP:RU
(Announcement 2001–83), room 5626
Internal Revenue Service
POB 7604, Ben Franklin Station
Washington, DC 20044

Alternatively, comments may be hand delivered between the hours of 8:30 a.m. and 4:30 p.m. to:

CC:M&SP:RU
(Announcement 2001–83)
Courier's Desk
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC

All written comments will be open to public inspection.

DRAFTING INFORMATION

The principal author of this announcement is James Flannery of the Employee Plans, Tax Exempt and Government Entities Division. For further information regarding this announcement, please contact Mr. Flannery at 1–202–283–9888 (not a toll-free number).

Changes in Method of Accounting

Announcement 2002–37

PURPOSE

In 1998, the Service published Notice 98–31 (1998–1 C.B. 1165), which proposed procedures for changes in method of accounting imposed by the Service under § 446(b) of the Internal Revenue Code and § 1.446–1(b) of the Income Tax Regulations ("involuntary changes"), and for accounting method issues resolved by the Service on a nonaccounting-method-change basis. Notice 98–31 also requested comments from the public in connection with these proposed procedures. The final involuntary change procedures appear concurrently in this Bulletin as Rev. Proc. 2002–18. The purpose of this announcement is to discuss some of the most significant and prevalent issues raised in the comments to Notice 98–31, and the manner in which those issues are addressed in the final guidance.

Along with Rev. Proc. 2002–18, this Bulletin contains Rev. Proc. 2002–19, which modifies the procedures contained in Rev. Proc. 97–27 (1997–1 C.B. 680) and Rev. Proc. 2002–9 (2002–3 I.R.B. 327) for taxpayers within the scope of those revenue procedures to obtain advance consent of the Commissioner, or automatic consent, respectively, to change a method of accounting ("voluntary changes"). Together, these three revenue procedures are intended to provide a more efficient use of Service and taxpayer resources with respect to accounting method issues and facilitate greater uniformity in the Service's resolution of accounting method issues.

CHANGES TO NOTICE 98–31

The Service received a number of comments in connection with Notice 98–31, which were considered carefully in revising and finalizing the proposed procedures in Rev. Proc. 2002–18. The following discussion describes some of the most significant comments and the manner in which the final guidance addresses them.

Commentators expressed concern that use of the term "timing issue" to describe the scope of the proposed procedures, and in particular an examining agent's discretion, inappropriately expanded the scope of the procedures to issues that affect timing but that should not be treated as changes in method of accounting, such as where the issue is an isolated occurrence or results from a change in underlying facts. The Service and Treasury Department did not intend to alter the definition of a change in method of accounting or to expand the scope of the proposed revenue procedure beyond issues concerning changes in method of accounting. To address the commentators' concerns, the final revenue procedure uses the term "accounting method issue" rather than "timing issue," clarifies the definition of an accounting method issue, and changes the reference for the definition of a change in method of accounting to § 1.446–1(e)(2).

Commentators expressed concern that the procedures set forth in Notice 98–31 would deprive examining agents of the authority to exercise discretion and professional judgment in resolving accounting method issues. Specifically, the commentators believed that the procedures would limit the existing authority of an examining agent to make findings of fact and to apply the law to those facts in determining whether an issue is an accounting method issue and whether the taxpayer's method of accounting is permissible. Rev. Proc. 2002–18 makes clear that these procedures do not limit or expand an examining agent's authority under existing delegation orders. Under Rev. Proc. 2002–18, an examining agent's ability to exercise professional judgment in accordance with existing auditing standards to make findings of fact, and to apply the law to the facts as found by the agent is preserved. Rev. Proc. 2002–18

also clarifies that although accounting method changes ordinarily will be implemented in the earliest open year under examination, and with a § 481(a) adjustment, there may be instances in which it is appropriate for an examining agent to consider deferring the year of change to a later year under examination, or to impose the change on a cut-off basis.

Similarly, some commentators believed that the procedures set forth in Notice 98–31 would limit the existing authority of Appeals and counsel for the government to resolve accounting method issues. Rev. Proc. 2002–18 clarifies that an appeals officer or counsel for the government may resolve an accounting method issue as an accounting method change (with or without compromise terms and conditions), using one of the nonaccounting-method change procedures provided in Rev. Proc. 2002–18, or using any other means deemed appropriate under the circumstances, consistent with existing delegation orders.

The background section of the proposed revenue procedure provides that the Service ordinarily will not initiate an accounting method change if the change will place the taxpayer in a position more favorable than if the taxpayer had not been contacted for examination (taxpayer-favorable change). Some commentators thought that this statement was out of place in a document intended to provide the procedures for how the Service will resolve accounting method issues that are raised on examination. The Service and Treasury Department agree that this statement does not belong in the background of the involuntary method change revenue procedure and thus have deleted it from Rev. Proc. 2002–18.

Consistent with Rev. Proc. 97–27 and Rev. Proc. 2002–9, the background section of the proposed revenue procedure provides that a change in the characterization of an item may constitute a change in method of accounting if the change has the effect of shifting income from one period to another. Some commentators objected to the inclusion of this statement, questioning whether a change in characterization of an item is properly considered a change in method of accounting and, in any event, whether such a rule belongs in the revenue procedures. Consistent with the purpose of these documents to provide procedural, rather than substantive, rules governing changes in method of accounting, the Service and the Treasury Department have not included section 2.01(3) of Notice 98–31 in Rev. Proc. 2002–18. Further, similar paragraphs have been removed from Rev. Proc. 97–27 and Rev. Proc. 2002–9 by Rev. Proc. 2002–19. The Service and Treasury Department are considering issuing separate guidance to address the issue of characterization in the context of a guidance project regarding the definition of a change in method of accounting.

The Service and Treasury Department were considering including guidance regarding the effect of closed years following the year of change (closed intervening years) in the final revenue procedure. In response to a specific request to opine as to the effect of closed intervening years, commentators suggested that substantive guidance addressing this issue should not be set forth in the final revenue procedure. Upon further consideration, the Service and Treasury Department agree that the resolution of this legal issue should not be set forth in Rev. Proc. 2002–18 and are considering issuing separate guidance to address this issue.

Finally, some commentators objected to the fact that, under Notice 98–31, the specified amount payable in the case of accounting method issues resolved by Appeals or counsel for the government on a time-value-of-money (TVM) basis is not treated as interest under § 163, and is not deductible under any provision of the Code. The commentators argued that this limitation was effectively punitive, and made the TVM alternative less attractive. In fact, as the sample computation contained in Notice 98–31 illustrates, the computation of the specified amount should be based on a tax-effected tax rate for taxpayers that would otherwise be entitled to a deduction if the specified amount were treated as interest under the Code. The use of a tax-effected rate effectively allows a deduction for the specified amount. A sentence is included in the final revenue procedure to clarify the use of tax-effected rates.

The Service and Treasury Department recognize that the TVM resolution has not been widely tested in practice, and that as the Service and taxpayers gain experience with this alternative, issues may arise that will require further clarifying guidance. The Service and Treasury Department anticipate that the TVM resolution will be most attractive in situations where it would be unnecessary to perform the complex interest credit calculation upon a subsequent change in method, such as when the resolution includes all years preceding a point at which a statutorily prescribed method becomes effective, a safe harbor method becomes available and is elected, or the issue of the proper method is otherwise resolved.

RELATED GUIDANCE

In addition to the proposed revenue procedure, Notice 98–31 outlined other guidance that the Service intended to publish as part of a comprehensive, and interrelated, set of procedures for resolving accounting method issues raised on audit. First, Notice 98–31 announced that the Service intended to publish guidance making the Coordinated Examination Program (CEP) early referral process provided in Rev. Proc. 96–9 (1996–1 C.B. 575) available to non-CEP taxpayers for the resolution of accounting method issues. This guidance has been published as Rev. Proc. 99–28 (1999–2 C.B. 109). By expanding the early referral procedures to include all taxpayers with respect to accounting method issues, the Service intends to provide a mechanism for expediting the resolution of those issues, which otherwise might be delayed pending the resolution of other (nonaccounting-method) issues raised in the course of the audit.

Second, the Service announced that it intended to publish guidance that would permit taxpayers under examination who otherwise cannot request a voluntary change in method of accounting under the advance consent revenue procedure (Rev. Proc. 97–27) or the automatic consent revenue procedure (Rev. Proc. 2002–9) to do so prospectively without audit protection. That guidance is contained in Rev. Proc. 2002–19. The modification is intended to provide a means for taxpayers under examination with an accounting method issue pending, as well as taxpayers before an area appeals office or a federal court with an accounting method issue under consideration, to change their method of accounting on a going forward

basis while the issue is in the process of being resolved for prior taxable years. This new procedure set forth in Rev. Proc. 2002–19 does not limit or extend the existing authority of an examining agent, appeals officer, or counsel for the government to resolve accounting method issues raised on examination.

Also in connection with finalizing Notice 98–31 and the related guidance, the Service and Treasury Department have reconsidered the appropriateness of a 4-year § 481(a) adjustment period for voluntary accounting method changes that result in a negative adjustment. The Service and Treasury Department have concluded that the objectives of prompt voluntary compliance are enhanced by reducing the § 481(a) adjustment period for such changes from 4 years to 1 year. This new 1-year § 481(a) adjustment period, reflected in Rev. Proc. 2002–19, is effective for taxable years ending on or after December 31, 2001.

Third, Notice 98–31 provided that the Service intended to publish a model closing agreement for Service-initiated accounting method changes in order to provide greater uniformity in the Service's resolution of accounting method issues. Appendices A and B of Rev. Proc. 2002–18 provide model closing agreements for use in finalizing accounting method changes imposed by the Service, and for finalizing accounting method issues resolved by the Service on a nonaccounting-method-change basis, respectively. Closing agreements are encouraged, but not required, in the case of accounting method issues resolved as accounting method changes. Closing agreements are required for accounting method issues resolved on a nonaccounting-method-change basis. In response to comments, the Service is considering whether it would be appropriate to change the existing delegation orders to authorize approval of closing agreements for accounting method change issues at lower levels.

Fourth, Notice 98–31 referred to certain other anticipated guidance projects (*i.e.*, guidance that would delegate limited discretionary authority to Examination to resolve certain accounting method issues, and guidance to expand the accelerated issue resolution procedures of Rev. Proc. 94–67 (1994–2 C.B. 800) to non-CEP taxpayers to allow these taxpayers and the Service to resolve accounting method issues for taxable years beyond the years under examination, before appeals, or before a federal court). The Service is interested in receiving comments from taxpayers and practitioners on the extent to which there is a need for this guidance.

Definition of Terms

Revenue rulings and revenue procedures (hereinafter referred to as"rulings") that have an effect on previous rulings use the following defined terms to describe the effect:

Amplified describes a situation where no change is being made in a prior published position, but the prior position is being extended to apply to a variation of the fact situation set forth therein. Thus, if an earlier ruling held that a principle applied to A, and the new ruling holds that the same principle also applies to B, the earlier ruling is amplified. (Compare with *modified*, below).

Clarified is used in those instances where the language in a prior ruling is being made clear because the language has caused, or may cause, some confusion. It is not used where a position in a prior ruling is being changed.

Distinguished describes a situation where a ruling mentions a previously published ruling and points out an essential difference between them.

Modified is used where the substance of a previously published position is being changed. Thus, if a prior ruling held that a principle applied to A but not to B, and the new ruling holds that it applies to both A and B, the prior ruling is modified because it corrects a published position. (Compare with *amplified* and *clarified*, above).

Obsoleted describes a previously published ruling that is not considered determinative with respect to future transactions. This term is most commonly used in a ruling that lists previously published rulings that are obsoleted because of changes in law or regulations. A ruling may also be obsoleted because the substance has been included in regulations subsequently adopted.

Revoked describes situations where the position in the previously published ruling is not correct and the correct position is being stated in the new ruling.

Superseded describes a situation where the new ruling does nothing more than restate the substance and situation of a previously published ruling (or rulings). Thus, the term is used to republish under the 1986 Code and regulations the same position published under the 1939 Code and regulations. The term is also used when it is desired to republish in a single ruling a series of situations, names, etc., that were previously published over a period of time in separate rulings. If the new ruling does more than restate the substance of a prior ruling, a combination of terms is used. For example, *modified* and *superseded* describes a situation where the substance of a previously published ruling is being changed in part and is continued without change in part and it is desired to restate the valid portion of the previously published ruling in a new ruling that is self contained. In this case, the previously published ruling is first modified and then, as modified, is superseded.

Supplemented is used in situations in which a list, such as a list of the names of countries, is published in a ruling and that list is expanded by adding further names in subsequent rulings. After the original ruling has been supplemented several times, a new ruling may be published that includes the list in the original ruling and the additions, and supersedes all prior rulings in the series.

Suspended is used in rare situations to show that the previous published rulings will not be applied pending some future action such as the issuance of new or amended regulations, the outcome of cases in litigation, or the outcome of a Service study.

Abbreviations

The following abbreviations in current use and formerly used will appear in material published in the Bulletin.

A—Individual.
Acq.—Acquiescence.
B—Individual.
BE—Beneficiary.
BK—Bank.
B.T.A.—Board of Tax Appeals.
C—Individual.
C.B.—Cumulative Bulletin.
CFR—Code of Federal Regulations.
CI—City.
COOP—Cooperative.
Ct.D.—Court Decision.
CY—County.
D—Decedent.
DC—Dummy Corporation.
DE—Donee.
Del. Order—Delegation Order.
DISC—Domestic International Sales Corporation.
DR—Donor.
E—Estate.
EE—Employee.
E.O.—Executive Order.
ER—Employer.
ERISA—Employee Retirement Income Security Act.
EX—Executor.
F—Fiduciary.
FC—Foreign Country.
FICA—Federal Insurance Contributions Act.
FISC—Foreign International Sales Company.
FPH—Foreign Personal Holding Company.
F.R.—Federal Register.
FUTA—Federal Unemployment Tax Act.
FX—Foreign Corporation.
G.C.M.—Chief Counsel's Memorandum.
GE—Grantee.
GP—General Partner.
GR—Grantor.
IC—Insurance Company.
I.R.B.—Intemal Revenue Bulletin.
LE—Lessee.
LP—Limited Partner.
LR—Lessor.
M—Minor.
Nonacq.—Nonacquiescence.
O—Organization.
P—Parent Corporation.
PHC—Personal Holding Company.
PO—Possession of the U.S.
PR—Partner.
PRS—Partnership.
PTE—Prohibited Transaction Exemption.
Pub. L.—Public Law.
REIT—Real Estate Investment Trust.
Rev. Proc—Revenue Procedure.
Rev. Rul.—Revenue Ruling.
S—Subsidiary.
S.P.R.—Statements of Procedural Rules.
Stat.—Statutes at Large.
T—Target Corporation.
T.C.—Tax Court.
T.D.—Treasury Decision.
TFE—Transferee.
TFR—Transferor.
T.I.R.—Technical Information Release.
TP—Taxpayer.
TR—Trust.
TT—Trustee.
U.S.C.—United States Code.
X—Corporation.
Y—Corporation.
Z—Corporation.

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[1] A cumulative list of all revenue rulings, revenue procedures, Treasury decisions, etc., published in Internal Revenue Bulletins 2001–27 through 2001–53 is in Internal Revenue Bulletin 2002–1, dated January 7, 2002.

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Key to Abbreviations:

Ann	Announcement
CD	Court Decision
DO	Delegation Order
EO	Executive Order
PL	Public Law
PTE	Prohibited Transaction Exemption
RP	Revenue Procedure
RR	Revenue Ruling
SPR	Statement of Procedural Rules
TC	Tax Convention
TD	Treasury Decision
TDO	Treasury Department Order

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