Internal Revenue
bulletin

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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.

INCOME TAX

Rev. Rul. 97–32, page 4.

LIFO; price indexes; department stores. The June 1997 Bureau of Labor Statistics price indexes are accepted for use by department stores employing the retail inventory and last-in, first-out inventory methods for valuing inventories for tax years ended on, or with reference to, June 30, 1997.

EMPLOYEE PLANS

Rev. Proc. 97–41, page 51.

Plan amendments; discretionary extension of the remedial amendment period. This procedure provides an extended remedial amendment period for certain qualified plans described in sections 401(a) and 403(a) of the Code and describes the time for making amendments to certain tax-sheltered annuities described in section 403(b).

Notice 97–45, page 7.

Highly compensated employee; definition. This notice sets forth the changes in determining who is a highly compensated employee within the meaning of section 414(q) of the Code as a result of section 1431 of the Small Business Job Protection Act of 1996.

ADMINISTRATIVE

Rev. Proc. 97–35, page 11.

Package design costs; methods of accounting. Three alternative methods of accounting for package design costs are provided: (1) the capitalization method; (2) the design-by-design and 60-month amortization method; and (3) the pool-of-cost and 48-month amortization method.

Rev. Proc. 97–36, page 14.

Last-in, first-out inventory method; methods of accounting. An alternative last-in, first-out (LIFO) inventory computation method of accounting is provided for taxpayers engaged in the trade or business of retail sales of new automobiles or new light-duty trucks.

Rev. Proc. 97–37, page 18.

Methods of accounting; automatic consent. Procedures are provided under which a taxpayer may obtain automatic consent of the Commissioner to change certain methods of accounting.

Rev. Proc. 97–38, page 43.

Warranty contracts; methods of accounting. Procedures are provided under which accrual method manufacturers, wholesalers, and retailers of motor vehicles or other durable consumer goods may, in certain specified and limited circumstances, include a portion of an advance payment related to the sale of a multi-year service warranty contract in gross income generally over the life of the service warranty obligation.

Rev. Proc. 97–39, page 48.

Original issue discount; methods of accounting. Taxpayers are allowed to use an aggregate method of accounting, termed the “principal-reduction” method, for de minimis original issue discount on certain loans originated by the taxpayer.

Rev. Proc. 97–40, page 50.

Late S corporation elections. If an S corporation election is filed late for a current taxable year, Rev. Proc. 97–40 provides a special procedure to permit taxpayers to request relief instead of applying for a private letter ruling.

Rev. Proc. 97–42, page 57.

Low-income housing tax credit. This procedure publishes the amounts of unused housing credit carryovers allocated to qualified states under section 42(h)(3)(D) of the Code for calendar year 1997.

Announcement 97–77, page 58.

This announces that the Internal Revenue Service will eliminate Form 4782, Employee Moving Expense Information, effective for tax year 1998.

Finding Lists begin on page 60.

Department of the Treasury
Internal Revenue Service

Mission of the Service

The purpose of the Internal Revenue Service is to collect the proper amount of tax revenue at the least cost; serve the public by continually improving the quality of our products and services; and perform in a manner warranting the highest degree of public confidence in our integrity, efficiency, and fairness.

Statement of Principles of Internal Revenue Tax Administration

The function of the Internal Revenue Service is to administer the Internal Revenue Code. Tax policy for raising revenue is determined by Congress.

With this in mind, it is the duty of the Service to carry out that policy by correctly applying the laws enacted by Congress; to determine the reasonable meaning of various Code provisions in light of the Congressional purpose in enacting them; and to perform this work in a fair and impartial manner, with neither a government nor a taxpayer point of view.

At the heart of administration is interpretation of the Code. It is the responsibility of each person in the Service, charged with the duty of interpreting the law, to try to find the true meaning of the statutory provision and not to adopt a strained construction in the belief that he or she is "protecting the revenue." The revenue is properly protected only when we ascertain and apply the true meaning of the statute.

The Service also has the responsibility of applying and administering the law in a reasonable, practical manner. Issues should only be raised by examining officers when they have merit, never arbitrarily or for trading purposes. At the same time, the examining officer should never hesitate to raise a meritorious issue. It is also important that care be exercised not to raise an issue or to ask a court to adopt a position inconsistent with an established Service position.

Administration should be both reasonable and vigorous. It should be conducted with as little delay as possible and with great courtesy and considerateness. It should never try to overreach, and should be reasonable within the bounds of law and sound administration. It should, however, be vigorous in requiring compliance with law and it should be relentless in its attack on unreal tax devices and fraud.

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 of a permanent nature 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 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.

With the exception of the Notice of Proposed Rulemaking and the disbarment and suspension list included in this part, none of these announcements are consolidated in the Cumulative Bulletins.

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 quarterly and semiannual basis, and are published in the first Bulletin of the succeeding quarterly and semiannual period, respectively.

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

Section 162.—Trade or Business Expenses

What procedures must a lawyer, handling cases on a contingent fee basis, use to obtain automatic consent of the Commissioner to change its method of accounting for advances paid to clients. See Rev. Proc. 97–37, page 18.

Section 165.—Losses

26 CFR 1.165–2: Obsolescence of nondepreciable property.

When may a taxpayer deduct a loss arising from the obsolescence of a package design. See Rev. Proc. 97–35, page 11.

What procedures must a taxpayer use to obtain automatic consent of the Commissioner to change its method of accounting for package design costs. See Rev. Proc. 97–37, page 18.

Section 166.—Bad Debts

What procedures must a taxpayer use to obtain automatic consent of the Commissioner to change from the § 585 reserve method of accounting to the § 166 specific charge-off method. See Rev. Proc. 97–37, page 18.

Section 167.—Depreciation

26 CFR 1.167(a)–3: Intangibles.

How may a taxpayer recover the costs of creating a package design. See Rev. Proc. 97–35, page 11.

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26 CFR 1.167(e)–1: Change in method.

What procedures must a taxpayer use to obtain automatic consent of the Commissioner to change its method of accounting for depreciation. See Rev. Proc. 97–37, page 18.

Section 168.—Accelerated Cost Recovery System

What procedures must a taxpayer use to obtain automatic consent of the Commissioner to change its method of accounting for depreciation. See Rev. Proc. 97–37, page 18.

Section 197.—Amortization of Goodwill and Other Intangibles

What procedures must a taxpayer use to obtain automatic consent of the Commissioner to change its method of accounting for amortization. See Rev. Proc. 97–37, page 18.

Section 263.—Capital Expenditures

26 CFR 1.263(a)–2: Examples of capital expenditures.

Must the costs of creating a package design be capitalized. See Rev. Proc. 97–35, page 11.

What procedures must a taxpayer use to obtain automatic consent of the Commissioner to change its method of accounting for package design costs. See Rev. Proc. 97–37, page 18.

Section 263A.—Capitalization and Inclusion in Inventory Costs of Certain Expenses

26 CFR §1.263A–1: Uniform capitalization of costs.

What procedures must a taxpayer use to obtain automatic consent of the Commissioner to change its method of accounting. See Rev. Proc. 97–37, page 18.

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26 CFR 1.263A–2: Rules relating to property produced by the taxpayer.

Are the costs incurred in connection with the development and design of product packages subject to the rules under section 263A. See Rev. Proc. 97–35, page 11.

Section 401.—Qualified Pension, Profit-sharing, and Stock Bonus Plans.

26 CFR 1.401(b)–1: Certain retroactive changes in plan.

A procedure describes when plans that are qualified under § 401(a) or § 403(a) must be amended for the Small Business Job Protection Act of 1996, Pub. L. 104–188, the Uruguay Round Agreements Act, Pub. L. 103–465, and the Uniformed Services Employment and Reemployment Rights Act of 1994, Pub. L. 103–353. See Rev. Proc. 97–41, page 51.

Section 403.—Taxation of Employee Annuities

A procedure describes when tax-sheltered annuity plans within the meaning of § 403(b) must be amended for the Small Business Job Protection Act of 1996, Pub. L. 104–188. See Rev. Proc. 97–41, page 51.

Section 446.—General Rule for Methods of Accounting

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

What procedures must a taxpayer use to obtain automatic consent of the Commissioner to change its method of accounting for package design costs. See Rev. Proc. 97–35, page 11.

How may an automobile dealer change its method of accounting to use the Alternative LIFO Method. See Rev. Proc. 97–36, page 14.

Section 451.—General Rule for Taxable Year of Inclusion

What procedures must a taxpayer use to obtain automatic consent of the Commissioner to change its method of accounting for the income from an advance payment related to the sale of a multi-year service warranty contract. See Rev. Proc. 97–37, page 18.

Section 454.—Obligations Issued at a Discount

26 CFR § 1.454–1: Obligations issued at a discount.

What procedures must a taxpayer use to obtain automatic consent of the Commissioner to change its method of accounting for the interest income on Series E or EE U.S. savings bonds. See Rev. Proc. 97–37, page 18.

Section 455.—Prepaid Subscription Income

26 CFR § 1.455–6: Time and manner of making election.

What procedures must a taxpayer use to obtain automatic consent of the Commissioner to change its method of accounting for prepaid subscription income. See Rev. Proc. 97–37, page 18.

Section 461.—General Rule for Taxable Year of Deduction

26 CFR § 1.461–4: Economic performance.

What procedures must a taxpayer use to obtain automatic consent of the Commissioner to change its method of accounting. See Rev. Proc. 97–37, page 18.

Section 471.—General Rule for Inventories

26 CFR § 1.471–1: Need for inventories;

26 CFR § 1.471–2: Valuation of inventories;

26 CFR § 1.471–3: Inventories at cost.

What procedures must a taxpayer use to obtain automatic consent of the Commissioner to change its method of accounting for certain cash discounts. See Rev. Proc. 97–37, page 18.

Section 472.—Last-in, First-out Inventories

26 CFR 1.472-1: Last-in, first-out inventories.

LIFO; price indexes; department stores. The June 1997 Bureau of Labor Statistics price indexes are accepted for use by department stores employing the retail inventory and last-in, first-out inventory methods for valuing inventories for tax years ended on, or with reference to, June 30, 1997.

Rev. Rul. 97-32

The following Department Store Inven-

tory Price Indexes for June 1997 were issued by the Bureau of Labor Statistics on July 16, 1997. The indexes are accepted by the Internal Revenue Service, under §1.472–1(k) of the Income Tax Regulations and Rev. Proc. 86–46, 1986–2 C.B. 739, for appropriate application to inventories of department stores employing the retail inventory and last-in, first-out inventory methods for tax years ended on, or with reference to, June 30, 1997.

The Department Store Inventory Price Indexes are prepared on a national basis and include (a) 23 major groups of departments, (b) three special combinations of the major groups — soft goods, durable goods, and miscellaneous goods, and (c) a store total, which covers all departments, including some not listed separately, except for the following: candy, foods, liquor, tobacco, and contract departments.

DRAFTING INFORMATION

The principal author of this revenue ruling is Stan Michaels of the Office of Assistant Chief Counsel (Income Tax and Accounting). For further information regarding this revenue ruling, contact Mr. Michaels on (202) 622-4970 (not a toll-free call).

BUREAU OF LABOR STATISTICS, DEPARTMENT STORE INVENTORY PRICE INDEXES BY DEPARTMENT GROUPS
(January 1941 = 100, unless otherwise noted)

Groups	June 1996	June 1997	Percent Change from June 1996 to June 1997[1]
1. Piece Goods	551.1	541.0	-1.8
2. Domestics and Draperies	641.0	644.1	0.5
3. Women's and Children's Shoes	649.3	651.0	0.3
4. Men's Shoes	895.4	904.0	1.0
5. Infants' Wear	627.1	642.5	2.5
6. Women's Underwear	535.4	539.3	0.7
7. Women's Hosiery	288.0	295.7	2.7
8. Women's and Girls' Accessories	545.5	569.4	4.4
9. Women's Outerwear and Girls' Wear	401.1	415.3	3.5
10. Men's Clothing	612.2	625.0	2.1
11. Men's Furnishings	584.5	589.8	0.9
12. Boys' Clothing and Furnishings	485.7	494.5	1.8
13. Jewelry	1011.5	1002.1	-0.9
14. Notions	774.1	752.1	-2.8
15. Toilet Articles and Drugs	877.8	913.5	4.1
16. Furniture and Bedding	673.6	673.2	-0.1
17. Floor Coverings	576.4	592.4	2.8
18. Housewares	808.7	808.1	-0.1
19. Major Appliances	245.5	243.5	-0.8
20. Radio and Television	79.3	76.2	-3.9
21. Recreation and Education[2]	112.8	109.5	-2.9
22. Home Improvements[2]	127.4	132.8	4.2
23. Auto Accessories[2]	107.5	108.0	0.5
Groups 1 – 15: Soft Goods	592.4	602.5	1.7
Groups 16 – 20: Durable Goods	469.7	465.9	-0.8
Groups 21 – 23: Misc. Goods[2]	113.7	112.2	-1.3
Store Total[3]	550.3	554.8	0.8

[1] Absence of a minus sign before percentage change in this column signifies price increase.
[2] Indexes on a January 1986 = 100 base.
[3] The store total index covers all departments, including some not listed separately, except for the following: candy, foods, liquor, tobacco, and contract departments.

What is the "Alternative LIFO Method." See Rev. Proc. 97–36, page 14.

26 CFR §1.472–6: Change from LIFO inventory method;

26 CFR §1.472–8: Dollar value method of pricing LIFO inventories.

What procedures must a taxpayer use to obtain automatic consent of the Commissioner to change from the LIFO method of accounting for all its LIFO inventory, or to change to an alternate LIFO inventory method. See Rev. Proc. 97–37, page 18.

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

26 CFR 1.481–4: Adjustments taken into account with consent.

How is the section 481(a) adjustment taken into account when a taxpayer changes its method of accounting for package design costs. See Rev. Proc. 97–35, page 11.

26 CFR §1.481–1: Adjustments in general;

26 CFR §1.481–4: Adjustments taken into account with consent.

What procedures must a taxpayer use to obtain automatic consent of the Commissioner to change a method of accounting. See Rev. Proc. 97–37, page 18.

Section 585.—Reserves for Losses on Loans of Banks

What procedures must a taxpayer use to obtain automatic consent of the Commissioner to change from the § 585 reserve method of accounting to the § 166 specific charge-off method. See Rev. Proc. 97–37, page 18.

Section 1273.—Determination of Amount of Original Issue Discount

26 CFR §1.1273–1: Definition of OID;

26 CFR §1.1273–2: Determination of issue price and issue date.

What procedures must a taxpayer use to obtain automatic consent of the Commissioner to change its method of accounting for certain de minimis original issue discount. See Rev. Proc. 97–37, page 18.

Section 1281.—Current Inclusion in Income of Discount on Certain Short-term Obligations

What procedures must a taxpayer use to obtain automatic consent of the Commissioner to change its method of accounting for interest income on short-term obligations, or for stated interest on short-term loans of cash method banks in the Eighth Circuit. See Rev. Proc. 97–37, page 18.

Section 1362.—Election; Revocation; Termination

26 CFR 1.1362–6: Elections and consents.

If a taxpayer files an S corporation election after the statutory date, but within 6 months of that statutory due date, may the taxpayer obtain relief under § 1362(b)(5) of the Internal Revenue Code without applying for a private letter ruling? See Rev. Proc. 97–40, page 50.

Section 1363.—Effect of Election on Corporation

What procedures must a taxpayer use to obtain automatic consent of the Commissioner to change its method of accounting? See Rev. Proc. 97–37, page 18.

Part III. Administrative, Procedural, and Miscellaneous

Highly Compensated Employee Definition

Notice 97–45

I. PURPOSE

This notice provides guidance relating to the definition of highly compensated employee ("HCE") under §414(q) of the Internal Revenue Code ("Code"), as amended by §1431 of the Small Business Job Protection Act of 1996, Pub. L. 104-188 ("SBJPA"). The §414(q) definition of HCE is incorporated by certain provisions of the Code that apply nondiscrimination requirements to various employee benefit plans, entities, or arrangements ("plans").

Specifically, this notice provides:

- Guidance on making the top-paid group election permitted by §414(q)(1)(B)(ii), under which an employee (other than a 5-percent owner) with compensation in excess of the dollar threshold is an HCE only if the employee is among the highest paid 20 percent of an employer's workforce.
- A new calendar year data election under which an employer that maintains one or more plans on a fiscal year basis has the option to use calendar year data to simplify the determination of whether an employee is an HCE on account of compensation under §414(q)(1)(B).
- Transition relief from certain requirements of the top-paid group election and the calendar year data election.
- Guidance on plan amendments to reflect the revised definition of HCE, including the application of the remedial amendment period under § 401(b), and certain other matters relating to the determination of HCE status.

II. BACKGROUND

(1) *Section 414(q) prior to SBJPA*. Prior to amendment by SBJPA, § 414(q)(1) generally provided that an employee was an HCE if, at any time during the year or the preceding year, the employee:

(A) was a 5-percent owner,

(B) received more than $100,000 (for 1996) in annual compensation from the employer,

(C) received more than $66,000 (for 1996) in annual compensation from the employer and was in the top-paid group of employees during the same year, or

(D) was an officer of the employer who received compensation in excess of $60,000 (for 1996).

(2) *Guidance under § 414(q) prior to SBJPA*. Under §1.414(q)–1T, A–14(b) of the temporary Income Tax Regulations, employers were allowed to make a calendar year calculation election, under which the preceding year's calculations relating to HCE determinations were made on the basis of the calendar year ending with or within the current year. Under section 4 of Rev. Proc. 93–42, 1993–2 C.B. 540, as modified by Rev. Proc. 95–34, 1995–2 C.B. 385, an employer was permitted to use a simplified method for determining HCEs. Rev. Proc. 95–34 also provided model plan language for employers to use the simplified method.

(3) *SBJPA amendments to § 414(q)*. Section 414(q)(1), as amended by SBJPA, provides that the term "highly compensated employee" means any employee who:

(A) was a 5-percent owner at any time during the year or the preceding year, or

(B) for the preceding year had compensation from the employer in excess of $80,000 and, if the employer so elects, was in the top-paid group for the preceding year.

The $80,000 amount is adjusted at the same time and in the same manner as under § 415(d), except that the base period is the calendar quarter ending September 30, 1996.

Pursuant to § 414(q)(3), an employee is in the top-paid group for any year if the employee is in the group consisting of the top 20 percent of the employees of the employer when ranked on the basis of compensation paid to employees during such year. An election pursuant to § 414(q)(1)(B)(ii), under which an employee (who is not a 5-percent owner) who has compensation in excess of $80,000 is not an HCE if the employee is not a member of the top-paid group, is referred to in this notice as a "top-paid group election."

The amendments made by § 1431 of SBJPA generally apply to years beginning after December 31, 1996.

III. EFFECT OF STATUTORY CHANGES ON PRIOR GUIDANCE

(1) *Prior guidance*. Because of the amendments made to § 414(q) by SBJPA, certain portions of § 1.414(q)–1T do not reflect current law. Except as provided in section III(2), the calendar year calculation election under A–14(b) of § 1.414(q)–1T does not apply for years beginning after December 31, 1996. In addition, the guidance provided under section 4 of Rev. Proc. 93–42 and under Rev. Proc. 95–34 does not apply for years beginning after December 31, 1996. The Service intends to publish guidance in the future that will make appropriate modifications to these items of guidance.

(2) *Transition relief for 1997*. For any year beginning on or after January 1, 1997 and before January 1, 1998, employers may continue to utilize the calendar year calculation election, taking into account the statutory amendments to § 414(q)(1)(B), and the elimination of § 414(q)(1)(C) and (D), by SBJPA.

IV. PERIODS FOR DETERMINING HCE STATUS

(1) *Determination years and look-back years*. HCE status is determined on the basis of the applicable year (as defined below) of the plan or other entity for which a determination is being made ("determination year") and the preceding twelve-month period ("look-back year") in accordance with § 414(q). Thus, under § 414(q), as amended by SBJPA, an employee is an HCE for a determination year if, (a) at any time during the determination year or the look-back year, the employee was a 5-percent owner or (b) for the look-back year, the employee had compensation from the employer in excess of $80,000 (as adjusted) and, if the employer so elects, was in the top-paid group.

(2) *Applicable year.*

(a) *Retirement plans.* The applicable year for a retirement plan is the plan year. For purposes of this notice, a retirement plan is a plan that is qualified under § 401(a) or 403(a) or described in § 403(b) or 408(k).

(b) *Nonretirement plans.* The applica-

ble year for a nonretirement plan is the plan year, as defined in the written plan document or otherwise identified in the Code and regulations. If a nonretirement plan does not have an identified plan year, then the employer may treat either the calendar year or the employer's fiscal year as the applicable year. For purposes of this notice, a nonretirement plan is any employee benefit arrangement to which the definition of HCE is applicable under a provision of the Code, other than a retirement plan.

V. IMPLEMENTATION OF ELECTIONS

(1) *Top-paid group election.* An employer may make a top-paid group election for a determination year. The effect of the top-paid group election is that an employee (who is not a 5-percent owner at any time during the determination year or the look-back year) with compensation in excess of $80,000 (as adjusted) for the look-back year is an HCE only if the employee was in the top-paid group for the look-back year. A top-paid group election, once made, applies for all subsequent determination years unless changed by the employer.

(2) *Calendar year data election.*

(a) This notice provides a new calendar year data election which an employer may make for a determination year. The effect of the calendar year data election is that the calendar year beginning with or within the look-back year is treated as the employer's look-back year for purposes of determining whether an employee is an HCE on account of the employee's compensation for a look-back year under § 414(q)(1)(B). A calendar year data election, once made, applies for all subsequent determination years unless changed by the employer.

(b) A calendar year data election made by an employer does not apply in determining whether the employer's employees are HCEs under § 414(q)(1)(A) on account of being 5-percent owners. Accordingly, if an employee is a 5-percent owner in either the look-back year or the determination year, then the employee is an HCE, without regard to whether the employee's employer makes a calendar year data election.

(c) If a plan has a calendar year as its determination year, then the immediately preceding calendar year is the look-back year for the plan. This is the case whether or not a calendar year data election is made. Thus, a calendar year data election would have no effect on the HCE determination for a calendar year plan.

(3) *No separate notification requirement.* Notification or filing with the Internal Revenue Service of a top-paid group election or a calendar year data election is not required in order for the election to be valid. However, under certain circumstances, plan amendments may be required to reflect the election. See section VII of this notice.

(4) *Cross-references.* Section VI of this notice provides a consistency requirement that applies if an employer maintains more than one plan. Section VII of this notice describes circumstances under which a top-paid group election or calendar year data election, or changes to such elections, may have to be reflected in plan documents.

VI. CONSISTENCY REQUIREMENT FOR ELECTIONS

(1) *Consistency requirement — in general.* Except as provided in section VI(3) and (4), in order to be effective, a top-paid group election made by an employer must apply consistently to the determination years of all plans of the employer that begin with or within the same calendar year. Similarly, except as provided in section VI(3) and (4), in order to be effective, a calendar year data election made by an employer must apply consistently to the determination years of all plans of the employer, other than a plan with a calendar year determination year, that begin within the same calendar year.

(2) *Interaction of top-paid group election and calendar year data election.* The top-paid group election and the calendar year data election are independent of each other. Thus, an employer making one of the elections is not required also to make the other election. However, if both elections are made, the look-back year in determining the top-paid group must be the calendar year beginning with or within the look-back year, in accordance with section V of this notice.

(3) *Multiemployer plans.* Satisfaction of the consistency requirement is determined without regard to any multiemployer plans in which the employer participates.

(4) *Transition relief for years prior to 2000.*

(a) *Transition relief for 1997.* The consistency requirement will not apply to determination years beginning with or within the 1997 calendar year. Thus, an employer may make a top-paid group election or a calendar year data election for a plan for a determination year beginning with or within 1997, without regard to whether the employer makes that election for any other plan.

(b) *Transition relief for 1998 and 1999.* For determination years beginning on or after January 1, 1998, and before January 1, 2000, (i) nonretirement plans are not subject to the consistency requirement, and (ii) satisfaction of the consistency requirement with respect to retirement plans is determined without regard to any plans of the employer that are nonretirement plans.

VII. QUALIFIED RETIREMENT PLAN AMENDMENTS FOR HCE DEFINITION

(1) *Qualified plans that must be amended.* If a retirement plan qualified under § 401(a) or 403(a) contains the definition of HCE under § 414(q), as in effect before SBJPA, the plan must be amended to reflect the definition of HCE under § 414(q), as amended by SBJPA. If an employer makes either a top-paid group or calendar year data election for a determination year, a plan that contains the definition of HCE must reflect the election. If the employer changes either a top-paid group or calendar year data election, the plan must be amended to reflect the change. However, a plan is not required to add a definition of HCE merely to reflect a top-paid group or calendar year data election.

(2) *Amendment date.* Rev. Proc. 97–41, 1997–33 IRB, provides that qualified retirement plans have a remedial amendment period under § 401(b) so that certain plan amendments for SBJPA are not required to be adopted before the last day of the first plan year beginning on or after January 1, 1999 (with a later date for governmental plans). Pursuant to Rev. Proc. 97–41, a plan provision reflecting the definition of HCE is a disqualifying provision and thus any plan amendments to reflect the definition of HCE in § 414(q), as amended by SBJPA, and to reflect any

choices regarding the top-paid group or calendar year data elections, are not required to be made until the end of this remedial amendment period. However, plans must be operated in accordance with the SBJPA changes to the HCE definition in § 414(q) as of the statutory effective date, and plans required to be amended to reflect those changes must be so amended retroactively effective as of that date. In addition, under Rev. Proc. 97–41, any retroactive amendments must reflect the choices made in the operation of the plan for each determination year, including choices made with respect to the top-paid group election and the calendar year data election (and any changes to those elections), and the first date that the plan operated in accordance with those choices (and any such changes).

VIII. OTHER ISSUES RELATING TO DETERMINATION OF HCE STATUS

(1) *Determining HCE status for 1997.* As noted earlier, the amendments made by § 1431 of the SBJPA generally apply to years beginning after December 31, 1996. However, § 1431(d)(1) provides that, in determining whether an employee is an HCE for years beginning in 1997, the amendments to § 414(q) are treated as having been in effect for years beginning in 1996. Accordingly, in determining whether an employee is an HCE for the determination year beginning with or within the 1997 calendar year, an employer must consider whether the employee was a 5-percent owner or had compensation in excess of $80,000 for the look-back year that began with or within the 1996 calendar year. An employer also may make the calendar year data election and/or the top-paid group election with respect to determination years beginning with or within the 1997 calendar year, in accordance with the guidance in this notice. The SBJPA amendments to § 414(q) are not applicable in determining the employer's HCEs for determination years beginning prior to January 1, 1997.

(2) *Highly compensated former employees.* For purposes of determining status as a highly compensated former employee under § 1.414(q)–1T, A–4, whether an employee was a highly compensated active employee for a determination year that ended on or after the employee's 55th birthday, or that was a separation year, is based on the rules applicable to determining HCE status as in effect for that determination year.

(3) *Determining 5-percent ownership by attribution of ownership interest to family members.* The definition of 5-percent owner in § 414(q)(2) refers to § 416(i)(1), which in turn refers to the attribution rules of § 318. Under the rules of §318, an individual is considered to own any stock owned directly or indirectly by the individual's spouse, children, grandchildren or parents. Consequently, an employee who is the spouse, child, parent or grandparent ("family member") of an individual who has a 5-percent interest in the employer at any time during the look-back year or the determination year is treated as an HCE under § 414(q)(1)(A), regardless of the family member's compensation level. These statutory provisions relating to the definition of 5-percent owner under § 414(q)(2) are different from the family aggregation rules under former § 414(q)(6) and are unaffected by the repeal of those rules under § 1431(b)(1) of SBJPA.

IX. EXAMPLES

The following examples illustrate the rules in this notice:

Example 1: (a) Employer A has maintained a defined benefit plan qualified under § 401(a) (Plan M) since 1996 with a plan year beginning April 1 and ending March 31. Employer A has never had a 5-percent owner. For Plan M's determination year beginning April 1, 2000 and ending March 31, 2001, Employer A does not make a calendar year data election or a top-paid group election.

(b) Under § 414(q)(1)(B), Employer A determines HCEs for Plan M's determination year beginning April 1, 2000, based upon the compensation of Employer A's employees in Plan M's look-back year. Thus, the HCEs are those employees who had compensation over $80,000 (as adjusted) during the period beginning April 1, 1999 and ending March 31, 2000.

Example 2: (a) Assume the same facts as in Example 1, except that Employer A hires a new employee, Employee X, on March 1, 2000 at an annual salary of $240,000. Employee X is not a 5-percent owner during the determination year beginning April 1, 2000 or the look-back year beginning April 1, 1999. During the month of March, 2000, Employee X's compensation was $20,000.

(b) Because Employee X's compensation during Plan M's look-back year beginning April 1, 1999 was less than $80,000 (as adjusted), Employee X is not an HCE for Plan M's determination year beginning April 1, 2000.

Example 3: (a) Employer B has maintained a qualified defined benefit plan (Plan N) since 1996 that has a calendar plan year. Employer B makes a top-paid group election for Plan N's 1998 determination year, which is the 1998 calendar year. Employer B had 15 employees in the 1997 calendar year and has never had a 5-percent owner. These employees, along with their compensation for the 1997 calendar year, are listed below.

Employees	*1997 Compensation*
1	$200,000
2	110,000
3	101,000
4	90,000
5-15	50,000 or less

(b) In determining Employer B's HCEs for the calendar year 1998 under the top-paid group election, Plan N's relevant look-back year is the 1997 calendar year. Employer B must determine whether any employee had compensation above $80,000, and was in the group consisting of the top 20 percent of the employees of Employer B in the 1997 calendar year, when ranked on the basis of compensation from Employer B during the 1997 calendar year.

(c) Employees 1, 2 and 3 comprise the top 20 percent of Employer B's 15 employees for the 1997 calendar year based on compensation from Employer B during the 1997 calendar year. Although Employee 4 had compensation over $80,000 in the 1997 calendar year, Employee 4 was not in the top-paid group for the 1997 calendar year and is therefore not an HCE for Plan N's 1998 determination year. This will be the case regardless of whether Employees 1, 2 and 3 continue to be employed in the 1998 calendar year.

Example 4: (a) Employer C has a qualified profit sharing plan (Plan O) with a calendar plan year. Employer C also has a qualified defined benefit plan (Plan P) with a plan year beginning April 1 and ending March 31. Employer C makes the

top-paid group election for Plan O for the calendar year 2000.

(b) Pursuant to the consistency rule requiring that the employer make the same election for all determination years of all plans of the employer that begin with or within the same calendar year, Employer C must also make the top-paid group election for Plan P's determination year beginning April 1, 2000 and ending March 31, 2001.

(c) The look-back year for purposes of determining whether any of Employer C's employees is an HCE under Employer C's top-paid group election for Plan O is the 1999 calendar year and for Plan P is the April 1, 1999 to March 31, 2000 year. The group of Employer C's employees that are HCEs for Plan O's 2000 determination year are those employees who had compensation above $80,000 (as adjusted) and who were in the top 20 percent of employees based on compensation for the 1999 calendar year, while the group of Employer C's employees that are HCEs for Plan P's determination year beginning April 1, 2000 are those employees who had compensation above $80,000 (as adjusted) and who were in the top 20 percent of employees based upon compensation for Plan P's look-back year beginning April 1, 1999.

Example 5: (a) Since 1998, Employer D has maintained a qualified cash or deferred arrangement under § 401(k) (Plan Q). Plan Q has a calendar plan year. Employer D has never made a calendar year data election or a top-paid group election for Plan Q and has never had a 5-percent owner. Under § 401(k)(3)(A)(ii), as amended by the SBJPA, unless an employer elects to use current year data for all eligible employees, the actual deferral percentage (ADP) test for the plan year is applied by comparing the ADP for all eligible HCEs for the plan year to the ADP for all other eligible employees (nonHCEs) for the preceding plan year. Employer D has not elected to use current year data for the nonHCEs for the 2000 calendar year.

(b) In conducting the ADP test for the 2000 calendar year, Employer D compares the ADP for the 2000 calendar year for the group of employees who had compensation above $80,000 (as adjusted) for the 1999 calendar year, and who are eligible under the plan for the 2000 calendar year, with the ADP for the 1999 calendar year for the group of employees who were nonHCEs for the 1999 calendar year and who were eligible under the plan for the 1999 calendar year. Employer D would have previously determined who the HCEs were for the 1999 calendar year, that is, the employees of Employer D who had compensation above $80,000 (as adjusted) for the 1998 calendar year. The nonHCEs for the 1999 calendar year are those employees who were employees in the 1999 calendar year and who were not determined to be HCEs for the 1999 calendar year.

Example 6: (a) Employer E has maintained a qualified profit sharing plan (Plan R) since 1996 with an April 1 to March 31 plan year. Employer E has also maintained a defined benefit plan (Plan S) since 1996 with an October 1 to September 30 plan year. Employer E decides to make the calendar year data election for determination years of Plan R and Plan S beginning in the 2000 calendar year. Thus, Employer E makes the election for Plan R's determination year beginning April 1, 2000 and ending March 31, 2001, and Plan S's determination year beginning October 1, 2000 and ending September 30, 2001.

(b) The 2000 calendar year begins within Plan R's look-back year beginning April 1, 1999 and ending March 31, 2000, and Plan S's look-back year beginning October 1, 1999 and ending September 30, 2000 and is treated as Employer E's look-back year for both Plans R and S for purposes of determining Employer E's HCEs on the basis of compensation. Thus, in determining HCE status under § 414(q)(1)(B) Employer E determines whether an employee has compensation for the look-back year in excess of $80,000 (as adjusted), and if applicable, the composition of the top-paid group, on the basis of compensation for the 2000 calendar year.

Example 7: (a) Assume the same facts as in *Example 6,* except that Employer E also maintains Plan T, a qualified defined benefit plan with a calendar plan year. Employer E fails to make the calendar year data election for Plan T.

(b) Because the consistency requirement for the calendar year data election is applied without regard to calendar year plans, the consistency requirement is satisfied regardless of whether Employer E makes a calendar year data election for Plan T.

Example 8: Assume the same facts as in *Example 6.* For Plan R, in determining whether any of Employer E's employees is an HCE on account of being a 5-percent owner, the employee's ownership in Employer E is examined for Plan R's 2000 and 2001 plan years (April 1, 1999 to March 31, 2000, and April 1, 2000 to March 31, 2001). For Plan S, in determining whether any of Employer E's employees is an HCE on account of being a 5-percent owner, the employee's ownership in Employer E is examined for Plan S's 2000 and 2001 plan years (October 1, 1999 to September 30, 2000, and October 1, 2000 to September 30, 2001). This is because the calendar year data election does not apply in determining whether an employee is a 5-percent owner.

Example 9: (a) Employer F maintains Plan U, a defined benefit plan with a calendar year plan year. Employee Y was employed by Employer F since 1990. Employee Y retired at age 65 from employment with Employer F in 1998. Employee Y was an HCE in 1992 under the rules applicable in 1992 to determine HCE status, but was not an HCE in any other year, including 1998.

(b) Because Employee Y was an HCE for a determination year (1992) ending on or after Employee Y's 55th birthday, Employee Y is a highly compensated former employee for determination years beginning after Employee Y's retirement.

X. PAPERWORK REDUCTION ACT

The collection of information contained in this notice has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545–1550.

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

The collection of information in this notice is in Section VII. This requirement to amend plan documents is necessary to update plan documents to reflect the amended definition of HCE under § 414(q). This information will be used to

determine which employees are HCEs for purposes of determining contributions, benefits, or the availability of other rights or features under the plan. The collection of information is required to obtain a benefit. The likely respondents are businesses or other for-profit institutions, nonprofit institutions, and small businesses or organizations.

The estimated total annual recordkeeping burden is 65,605 hours.

The estimated annual burden per recordkeeper varies from 10 minutes to 30 minutes, depending on individual circumstances, with an estimated average of 18 minutes. The estimated number of recordkeepers is 218,683.

Books or records relating to a 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.

XI. COMMENTS

This notice does not address all of the procedural requirements that may be necessary to implement the top-paid group election or the calendar year data election for future years. However, any additional requirements would be applied prospectively only. The Treasury and the Service invite comments and suggestions regarding procedural issues and the other matters discussed in this notice.

Comments can be addressed to CC:DOM:CORP:R (Notice 97–45), room 5228, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. In the alternative, comments may be hand delivered between the hours of 8 a.m. and 5 p.m. to CC:DOM:CORP:R (Notice 97–45), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. Alternatively, taxpayers may transmit comments electronically via the IRS Internet site at http://www.irs.ustreas.gov/prod/tax_regs/comments.html.

DRAFTING INFORMATION

The principal author of this notice is Ingrid Grinde of the Employee Plans Division. For further information regarding this notice, please contact the Employee Plans Division's taxpayer assistance telephone service at (202) 622-6074 or (202) 622-6075, between the hours of 1:30 p.m. and 3:30 p.m. Eastern Time, Monday through Thursday, or Ms. Grinde at (202) 622-6214, or Patricia McDermott of the Office of the Associate Chief Counsel (Employee Benefits and Exempt Organizations) at (202) 622-6030. These are not toll-free numbers.

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26 CFR 601.204: Changes in accounting periods and in methods of accounting.

(Also Part I, §§ 165, 167, 263, 263A, 446, 481; 1.165-2, 1.167(a)-3, 1.263(a)-2, 1.263A-2, 1.446-1, 1.481-4.)

Rev. Proc. 97-35

SECTION 1. PURPOSE

.01 This revenue procedure describes three alternative methods of accounting for package design costs: (1) the capitalization method (*see* section 5.01 of this revenue procedure), (2) the design-by-design capitalization and 60-month amortization method (*see* section 5.02 of this revenue procedure), and (3) the pool-of-cost capitalization and 48-month amortization method (*see* section 5.03 of this revenue procedure). A taxpayer may change to or adopt any one of these three methods. The procedures for a taxpayer to change to one of these three methods are provided in Rev. Proc. 97–37, page 18, which provides simplified and uniform procedures to obtain automatic consent to make this and other changes in methods of accounting. This revenue procedure modifies and supersedes Rev. Proc. 90–63, 1990–2 C.B. 664.

.02 The three methods of accounting for package design costs described in this revenue procedure are the same methods of accounting that were described in Rev. Proc. 90–63. Accordingly, a taxpayer that properly changed to or adopted one of these methods pursuant to Rev. Proc. 90–63 is not required to change its method of accounting to comply with this revenue procedure.

SECTION 2. DEFINITIONS

For purposes of this revenue procedure, the terms "package design" and "package design cost" have the meanings provided in Rev. Rul. 89–23, 1989–1 C.B. 85. If the taxpayer develops the package design, the term includes the cost of materials, labor, and overhead associated with the design, including all design exploration and study (for example, the development of any related design which, although abandoned, advances the development of the design selected), refinement of the basic design selected, testing, and preparation of the final master comprehensive design. If an independent contractor performs the work, the term includes all billings related to the development of the particular package, including all design exploration and study (for example, the development of any related design which, although abandoned, advances the development of the design selected), refinement of the basic design selected, testing, and preparation of the final master comprehensive design. If the taxpayer purchases the package, the term includes the purchase price. The costs associated with coupon inserts, refund offers, and other short-lived promotion-related changes are specifically excepted from the definition of "package design cost."

SECTION 3. BACKGROUND

.01 Section 263(a) of the Internal Revenue Code provides that no deduction is allowed for any amount paid for new buildings or for permanent improvements or betterments made to increase the value of any property or estate. Section 1.263(a)–2 of the Income Tax Regulations includes in its examples of capital expenditures the costs of acquiring property having a useful life substantially beyond the tax year.

.02 An expenditure generally must be capitalized under § 263 if the expenditure creates, enhances, or is part of the cost of acquiring a tangible or intangible asset having a useful life that extends substantially beyond the end of the tax year in which the expenditure is incurred. *See INDOPCO, Inc. v. Commissioner*, 503 U.S. 79 (1992); *Commissioner v. Lincoln Savings and Loan Association*, 403 U.S. 345 (1971), 1971-2 C.B. 116; *Central Texas Savings and Loan Association v. United States*, 731 F.2d 1181 (5th Cir. 1984); *Ellis Banking Corp. v. Commissioner*, 688 F.2d 1376 (11th Cir. 1982), *cert. denied,* 463 U.S. 1207 (1983); and *Cleveland Electric Illuminating Company v. United States,* 7 Cl. Ct. 220 (1985). Generally, taxpayers must capitalize package design costs incurred prior to

January 1, 1987 under § 263 because those costs create intangible assets having useful lives that extend substantially beyond the end of the tax year in which the costs are incurred. *See* Rev. Rul. 89-23.

.03 Section 263A, enacted by the Tax Reform Act of 1986, provides, in part, for the capitalization of certain direct and indirect costs with respect to real or tangible personal property produced by the taxpayer. All costs that are incurred with respect to real or tangible personal property that the taxpayer produces are to be capitalized with respect to the property. The term "produce" includes construct, build, install, manufacture, develop, improve, create, raise, or grow. For purposes of §263A, "tangible personal property" includes a film, sound recording, video tape, book, or similar property embodying words, ideas, concepts, images, or sounds (*see* 2 H.R. Conf. Rep. No. 841, 99th Cong., 2d Sess. II–308 (1986), 1986–3 (Vol. 4) C.B. 308) without regard to whether the property is treated as tangible or intangible under other provisions of the Code. *See* § 1.263A-2(a)(2)(ii). Section 263A and the regulations thereunder require that costs incurred after December 31, 1986 in connection with the development and design of product packages must be capitalized. *See* Rev. Rul. 89–23.

.04 As stated in Rev. Rul. 89–23, package designs generally do not have an ascertainable useful life, and thus no depreciation or amortization is allowed under § 167 and the regulations thereunder. *See* § 1.167(a)–3. Only when such a package design is abandoned may the capitalized costs be deducted. *See* § 165 and §1.165–2(a).

.05 Thus, taxpayers are generally required under the Code and regulations to use the capitalization method of accounting for package design costs described in section 5.01 of this revenue procedure. However, to minimize disputes regarding the accounting for package design costs, the Internal Revenue Service, as a matter of administrative convenience, will allow a taxpayer that complies with the requirements of this revenue procedure to choose one of two alternative methods of accounting for package design costs:

(1) the capitalization and 60-month amortization method described in section 5.02 of this revenue procedure, determined on a design-by-design basis for all package designs or;

(2) the capitalization and 48-month amortization method described in section 5.03 of this revenue procedure, determined on a pool-of-cost basis for all package design costs.

SECTION 4. SCOPE

This revenue procedure applies to a taxpayer that wants to change to or adopt a method of accounting for package design costs. A change in method of accounting for package design costs made pursuant to this revenue procedure does not affect the taxpayer's method of accounting for intangible property other than package designs described in section 2 of this revenue procedure.

SECTION 5. ALTERNATIVE METHODS OF ACCOUNTING

.01 *The capitalization method.*

(1) *Description of method.* The treatment of the costs of developing new package designs or modifying existing designs in accordance with the capitalization method constitutes a permissible method of accounting. Under the capitalization method, the taxpayer must capitalize the costs of developing (or modifying) any package design if the asset created by those costs has no ascertainable useful life or an ascertainable useful life that extends substantially beyond the end of the tax year in which the costs are incurred. If the asset created by the costs has an ascertainable useful life, the taxpayer may amortize the costs ratably over the useful life, beginning with the month the package design (or modification to the design) is placed in service. If the asset created by the costs has no ascertainable useful life, the taxpayer may deduct the costs only upon the disposition or abandonment of the package design (or modification to the design). *See* Rev. Rul. 89-23.

(2) *Computation of basis.* The basis of each package design (or modification to the design) subject to capitalization is determined by applying the provisions of § 263 and the regulations thereunder to costs incurred prior to January 1, 1987, and § 263A and the regulations thereunder to costs incurred after December 31, 1986 (regardless of the tax year the design (or modification to the design) is placed in service). The costs required to be capitalized are described in section 2 of this revenue procedure.

.02 *The design-by-design capitalization and 60-month amortization method.*

(1) *Description of method.* The treatment of the costs of developing new package designs or modifying existing designs in accordance with the design-by-design capitalization and 60-month amortization method constitutes a permissible method of accounting. Under the design-by-design capitalization and 60-month amortization method, the taxpayer must capitalize the costs of developing (or modifying) any package design if the asset created by those costs has no ascertainable useful life or an ascertainable useful life that extends substantially beyond the end of the tax year in which the costs are incurred. The taxpayer must amortize the basis of any package design (or modification to the design) subject to capitalization over a period of 60 months. Thus, in computing taxable income, the basis of each package design (or modification to the design) subject to capitalization is allowed as a deduction ratably over a 60-month period, beginning with the month the design (or modification to the design) is treated as placed in service. *See* section 5.02(3) of this revenue procedure. If the package design (or modification to the design) is disposed of or abandoned within the 60-month period, the taxpayer is permitted to deduct the unamortized portion of the basis of the design (or modification to the design) in the tax year of disposition or abandonment.

(2) *Computation of basis.* Under the design-by-design capitalization and 60-month amortization method, the basis of each package design (or modification of the design) subject to capitalization must be determined by applying the provisions of § 263 and the regulations thereunder to costs incurred prior to January 1, 1987, and § 263A and the regulations thereunder to costs incurred after December 31, 1986 (regardless of the tax year the design (or modification to the design) is placed in service). The costs required to be capitalized are described in section 2 of this revenue procedure.

(3) *Half-year convention.* Under the design-by-design capitalization and 60-month amortization method, the amortization allowance for each package design

(or modification to the design) subject to capitalization must be determined by treating a design (or modification to the design) placed in service during the tax year as placed in service on the mid-point of the tax year. If the tax year in which the package design (or modification to the design) is placed in service is 12 full months, the design (or modification to the design) is treated as placed in service on the first day of the seventh month of the tax year. For guidance in computing the amortization allowance under the design-by- design capitalization and 60-month amortization method when a package design (or modification to the design) is placed in service in a taxable year of less than 12 months (a short taxable year), see Rev. Proc. 89-15, 1989-1 C.B. 816.

.03 *The pool-of-cost capitalization and 48-month amortization method.*

(1) *Description of method.* The treatment of the costs of developing new package designs or modifying existing designs in accordance with the pool-of-cost capitalization and 48-month amortization method constitutes a permissible method of accounting. Under the pool-of-cost capitalization and 48-month amortization method, the taxpayer must capitalize all its package design costs and amortize the costs over a period of 48 months. Thus, in computing taxable income, package design costs incurred during the tax year are allowed as a deduction ratably over a 48-month period, beginning with the month the costs are treated as incurred. See section 5.03(3) of this revenue procedure. The taxpayer may not deduct the unamortized portion of the cost of a package design (or modification to the design) if the design (or modification to the design) is never placed in service or is disposed of or abandoned within the 48-month period.

(2) *Costs subject to capitalization.* All package design costs are subject to capitalization without regard to whether the costs create a package design (or modification to the design) having an ascertainable useful life that extends substantially beyond the end of the tax year in which the costs are incurred. Thus, all package design costs incurred prior to January 1, 1987 that would be capitalized under § 263 and the regulations thereunder but for the fact that the costs create a package design (or modification to the design) having an ascertainable useful life that does not extend substantially beyond the end of the tax year in which the costs are incurred must be capitalized. All package design costs incurred after December 31, 1986 that would be capitalized under § 263A and the regulations thereunder but for the fact that the costs create a package design (or modification to the design) having an ascertainable useful life that does not extend substantially beyond the end of the tax year in which the costs are incurred must be capitalized. The costs required to be capitalized are described in section 2 of this revenue procedure.

(3) *Half-year convention.* Under the pool-of-cost capitalization and 48-month amortization method, the amortization allowance for package design costs must be determined by treating all package design costs incurred during the tax year as incurred on the mid-point of the tax year. If the tax year in which the package design costs are incurred is 12 full months, the costs are treated as incurred on the first day of the seventh month of the tax year. For guidance in computing the amortization allowance under the pool-of-cost capitalization and 48-month amortization method when package design costs are incurred in a taxable year of less than 12 months (a short taxable year), see Rev. Proc. 89–15.

SECTION 5. CHANGING PACKAGE DESIGN COSTS METHOD

.01 *Automatic change.* A taxpayer wanting to change its method of accounting for package design costs must follow the provisions in Rev. Proc. 97-37.

.02 *Section 481(a) adjustment.*

(1) *Change to the capitalization method.* If the taxpayer is changing its method of accounting for package design costs to the capitalization method, the § 481(a) adjustment (which will be positive) will restore to income the total amounts deducted or amortized in tax years prior to the year of change with respect to all package designs (or modifications to designs) subject to capitalization and not abandoned as of the first day of the tax year of change, less the amounts that would have been amortized during the tax years prior to the year of change with respect to designs (or modifications to designs) which had an ascertainable useful life on the date the designs (or modifications to the designs) were placed in service. The § 481(a) adjustment is the difference at the beginning of the tax year of change between the basis of all such package designs (or modifications to designs) determined under the taxpayer's present method of accounting and the basis redetermined under the capitalization method.

(2) *Change to the design-by-design capitalization and 60-month amortization method.* If the taxpayer is changing its method of accounting for package design costs to the design-by-design capitalization and 60-month amortization method, the § 481(a) adjustment is equal to the total amounts deducted or amortized in tax years prior to the year of change with respect to all package designs (or modifications to designs) subject to capitalization and not abandoned as of the first day of the tax year of change, less the amounts that would have been amortized during the tax years prior to the year of change with respect to such designs (or modifications to designs) had the design-by-design capitalization and 60-month amortization method been used.

(3) *Change to the pool-of-cost capitalization and 48-month amortization method.* If the taxpayer is changing its method of accounting for package design costs to the pool-of-cost capitalization and 48-month amortization method, the § 481(a) adjustment is equal to the total amounts deducted or amortized in tax years prior to the year of change with respect to all package design costs treated as incurred during the tax years prior to the year of change, less the amounts that would have been amortized during the tax years prior to the year of change with respect to such costs had the pool-of-cost capitalization and 48-month amortization method been used.

SECTION 6. INQUIRIES

Inquiries regarding this revenue procedure may be addressed to the Commissioner of Internal Revenue, Attention: Office of Assistant Chief Counsel (Income Tax and Accounting) CC:DOM:IT&A, 1111 Constitution Avenue, NW, Washington, DC 20224.

SECTION 7. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 90-63, 1990-2 C.B. 664, is modified, and as modified, is superseded. However, see the transition rules in section 13.02 of Rev. Proc. 97-37.

SECTION 8. EFFECTIVE DATE

This revenue procedure is effective on August 18, 1997.

DRAFTING INFORMATION

This revenue procedure was drafted in the Office of Assistant Chief Counsel (Income Tax & Accounting). For further information regarding this revenue procedure, contact Robert A. Testoff on (202) 622-4800 (not a toll free call).

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26 CFR 601.204: Changes in accounting periods and in methods of accounting.

(Also Part I, §§ 446, 472; 1.446–1, 1.472–1.)

Rev. Proc. 97–36

SECTION 1. PURPOSE

This revenue procedure provides an alternative last-in, first-out (LIFO) inventory computation method (the "Alternative LIFO Method") for a taxpayer engaged in the trade or business of retail sales of new automobiles or new light-duty trucks ("automobile dealer"). A taxpayer may change to or adopt the Alternative LIFO Method. The procedures for a taxpayer to change to the Alternative LIFO Method are provided in Rev. Proc. 97–37, page 18, which provides simplified and uniform procedures to obtain automatic consent to make this and other changes in methods of accounting. This revenue procedure modifies and supersedes Rev. Proc. 92–79, 1992–2 C.B. 457.

.02 The Alternative LIFO Method described in this revenue procedure is the same method of accounting that was described in Rev. Proc. 92–79. Accordingly, a taxpayer that properly changed to or adopted this method pursuant to Rev. Proc. 92-79 is not required to change its method of accounting to comply with this revenue procedure.

SECTION 2. BACKGROUND

.01 *In general.* Section 472(a) of the Internal Revenue Code provides that a taxpayer may use the LIFO inventory method of inventorying goods if, among other requirements, the change to, and use of, the method is in accordance with such regulations as the Secretary may prescribe as necessary in order that the use of the method may clearly reflect income.

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

.03 *Link-chain method.* Section 1.472–8(e)(1) permits the use of a "link-chain" method of computing the LIFO value of a dollar-value pool if the "double-extension" method and an "index" method would be impractical or unsuitable in view of the nature of the inventory in the dollar-value pool. Further, in applying a link-chain method, an index may be computed by "double extending" a representative portion of the inventory in a dollar-value, link-chain pool at both the current-year cost and the prior-year cost. Additionally, an index may be computed under a link-chain method using other sound and consistent statistical methods.

.04 *Acceptable methods.* Under existing LIFO inventory provisions, there are three general dollar-value LIFO methods:

(1) *Simplified dollar-value LIFO method.*

(a) Section 474 provides an elective simplified dollar-value LIFO method for eligible small businesses. In general, a taxpayer is an eligible small business for any taxable year if its average annual gross receipts for the three preceding years do not exceed $5,000,000.

(b) The simplified dollar-value LIFO method under § 474 is based on a so-called link-chain method of computing the LIFO value of an inventory pool. Under § 474, inventory pools are established by the major categories in the applicable Government price index, and an annual index for each pool is obtained from that Government price index. Therefore, under § 474, an eligible automobile dealer uses a single inventory pool for new automobiles and new trucks under the major category, transportation equipment, in the Producer Price Index ("PPI") published by the Bureau of Labor Statistics ("BLS").

(c) Under this link-chain method, two price indexes are computed for each pool, an annual index and a cumulative index. The annual index represents the change in price level of goods in the ending inventory of the pool for the current year from the price level of comparable goods for the prior year. Under § 474, the annual index for computing the LIFO value of an automobile dealer's single inventory pool is obtained using the price change from the preceding taxable year for the major index category, transportation equipment, from the PPI.

(d) The cumulative index represents the price level change from the beginning of the base year to the end of the current year and is the product of each of the annual indexes. The cumulative index is used to convert the total current-year cost in an inventory pool at the close of the taxable year to base-year dollars by dividing the total current-year cost by the cumulative index, and also to determine the value of any incremental increase in the pool to be added to the ending inventory of the preceding year by multiplying that increment by the cumulative index.

(2) *Inventory price index computation method.*

(a) Section 1.472-8(e)(3) provides another simplified dollar-value LIFO method, the inventory price index computation (IPIC) method, which is available to all taxpayers. An automobile dealer using the IPIC method must use that method in determining the value of all goods for which the automobile dealer has elected to use the LIFO method. Under the IPIC method, special inventory pooling rules permit an automobile dealer to establish a single inventory pool for new automobiles and new trucks under the major category of the applicable Government price index published by the BLS. *See* § 1.472–8(e)(3)(iv) and Rev. Proc. 84–57, 1984–2 C.B. 496.

(b) The IPIC method under § 1.472–8(e)(3) is also based on a link-chain method of computing the LIFO value of an inventory pool. The annual index for the pool is generally computed using a stated percentage of the percent change in the applicable detailed index(es) for the major category of the ap-

plicable Government price index. The stated percentage is 80 percent unless a taxpayer qualifies as an eligible small business under § 474, in which case the stated percent is 100 percent.

(3) *General dollar-value LIFO method.*

(a) If an automobile dealer does not want to use either the simplified dollar-value LIFO method for certain small businesses provided in § 474 of the Code (if the taxpayer is eligible) or the IPIC method provided in § 1.472–8(e)(3), the automobile dealer may use the general dollar-value LIFO inventory rules contained in § 1.472–8. Under these general rules, an automobile dealer establishes inventory pools for each separate trade or business under § 1.472–8(c) by major lines, types, or classes of goods (for example, one separate pool for all new automobiles and another separate pool for all new trucks). *See Fox Chevrolet, Inc. Maryland v. Commissioner,* 76 T.C. 708 (1981), *acq.,* 1984–2 C.B. 1, and *Richardson Investments, Inc., and Subsidiaries v. Commissioner,* 76 T.C. 736 (1981).

(b) An automobile dealer may use the double-extension method, an index method, or a link-chain method, to compute the LIFO value of its inventory pools. Under all three of these methods, automobile dealers use their own cost data to compute the index for each pool. Because of the nature of the items in their pools, automobile dealers generally use a link-chain method. The annual index for each pool under the link-chain method is computed by "double extending" (that is, pricing) the vehicles (or "items") in each inventory pool as of the close of the taxable year at the automobile dealer's own current year cost and at the automobile dealer's own prior-year cost. For each pool, the total current-year cost of the vehicles in ending inventory is divided by the total prior-year cost of the vehicles in ending inventory to compute the annual index for the current year. The vehicles used to determine the dealer's own prior-year cost of vehicles in the current year's ending inventory must be comparable to the vehicles used to compute the current-year cost of vehicles in the current year's ending inventory. For purposes of this revenue procedure, this is referred to as the § 1.472-8 "comparability requirement."

.05 *New alternative method.* In addition to the three general dollar-value LIFO methods briefly described in section 2.04 of this revenue procedure, this revenue procedure provides an additional dollar-value LIFO method for automobile dealers, the Alternative LIFO Method. This method is described in section 4 of this revenue procedure.

SECTION 3. SCOPE

The Alternative LIFO Method is available to any automobile dealer engaged in the business of retail sales of new automobiles or new light-duty trucks for its LIFO inventories of new automobiles and new light-duty trucks. Light-duty trucks are trucks with a gross vehicle weight of 14,000 pounds or less, which are also referred to as class 1, 2, or 3 trucks.

SECTION 4. ALTERNATIVE LIFO METHOD

.01 *In general.*

(1) The Alternative LIFO Method is a comprehensive dollar-value, link-chain LIFO method of accounting that encompasses several LIFO sub-methods and may only be used by an automobile dealer engaged in the trade or business of retail sales of new automobiles or new light-duty trucks to value its inventory of new automobiles and new light-duty trucks.

(2) The Alternative LIFO Method is designed to simplify the dollar-value computations of automobile dealers. Under the authority of § 1.446–1(c)(2)(ii), the Commissioner will waive strict adherence of the § 1.472–8 comparability requirement in applying the Alternative LIFO Method, provided a taxpayer uses the compensating sub-methods described in section 4.02 of this revenue procedure, which, in the opinion of the Commissioner, are necessary to ensure that the Alternative LIFO Method clearly reflects income. These sub-methods include requirements that (1) the current-year cost of a new item be used as the prior year cost for the new item, and (2) the automobile dealer use the manufacturer's base model codes to define items for purposes of § 1.472–8. Generally, the manufacturer's base model codes used in defining items and identifying new items under the Alternative LIFO Method have an average life of approximately five to seven years.

(3) The Alternative LIFO Method includes, by definition, all its sub-methods. Individual sub-methods used alone, or in combination with some but not all of the sub-methods of the Alternative LIFO Method, may not clearly reflect income. Therefore, use of the Alternative LIFO Method is conditioned upon an automobile dealer computing its LIFO inventory using all the sub-methods, definitions, and special rules provided in section 4.02 of this revenue procedure, and the computational methodology provided in section 4.03 of this revenue procedure.

(4) The Alternative LIFO Method will be accepted by the Commissioner as an appropriate method of computing an inventory index, and the use of the Alternative LIFO Method to compute the value of the inventory pool or pools will be accepted as accurate, reliable, and suitable. The automobile dealer's computations under the Alternative LIFO Method are, however, subject to verification by the district director upon examination of the automobile dealer's return.

.02 *Sub-methods, definitions, and special rules.*

(1) *LIFO pools.* For each separate trade or business, (a) all new automobiles (regardless of manufacturer), including those used as demonstrators, must be included in one dollar-value LIFO pool, and (b) all new light-duty trucks (regardless of manufacturer), including those used as demonstrators, must be included in another separate dollar-value LIFO pool.

(2) *Specific identification increment method.* The current-year cost of the items making up a pool must be determined by reference to the actual cost of the specific new automobiles or new light-duty trucks in ending inventory. Therefore, the actual cost of the specific vehicles on hand at year end will be the current-year cost of such vehicles.

(3) *Item of inventory.* An item of inventory ("item category") must be determined using the entire manufacturer's base model code number that represents the most detailed description of the base vehicle's characteristics, such as model line, body style, trim level, etc. The manufacturer's base model code numbers are almost always used as part of the vehicle identification on each dealer invoice (for example, a domestic model, trim level, 4-door sedan has a specific model code; a foreign model, 4-door sedan, trim level,

5-speed has a specific model code). In the case of conversion vans, an item of inventory must be determined using both (a) the entire manufacturer's base model code, as described in the preceding sentence, and (b) the most detailed conversion package designation.

(4) *Cost of the vehicle used for purposes of computing the pool index.* The actual base vehicle cost of each of the specific vehicles in ending inventory is used to compute the index under the Alternative LIFO Method. The base vehicle cost of each vehicle is not adjusted for any options, accessories, or other costs. The pool index computed from only the base vehicle cost of vehicles is applied to the total vehicle cost, including options, accessories, and other costs, of all vehicles in the pool at the end of the taxable year.

(5) *Definition of a new item.* A new item category, which is an item category not considered in existence in the prior taxable year, is one of the following: (a) any new or reassigned manufacturer's model code, as described in section 4.02(3) of this revenue procedure, that is caused by a change in an existing vehicle, or (b) a manufacturer's model code, as described in section 4.02(3) of this revenue procedure, created or reassigned because the classified vehicle did not previously exist. Additionally, if there is no change in a manufacturer's model code, but there has been a change to the platform (i.e., the piece of metal at the bottom of the chassis that determines the length and width of the vehicle and the structural set-up of the vehicle) that results in a change in track width or wheel-base, whether or not the same model name was previously used by the manufacturer, a new item category is created.

(6) *Treatment of a new item not in existence in the prior year.* The automobile dealer must use the current-year base vehicle cost of the new item category as the prior-year base vehicle cost of that item category.

(7) *Item in existence in the prior year, but not stocked.* If an item in ending inventory was not stocked by the automobile dealer at the end of the prior year, but was in existence in the prior year, the automobile dealer must determine the prior-year base vehicle cost for that item by reconstructing what the base vehicle cost for the item category would have been using a manufacturer's price list that provides dealer purchase prices. For each such item category, the manufacturer's price list that must be used by the automobile dealer is the list in effect as of the beginning of the last month of the prior taxable year.

.03 *Computational methodology.*

The following rules are applied to compute the LIFO value for each pool of an automobile dealer's ending inventory under the Alternative LIFO Method:

STEP 1. Obtain the actual invoice for each vehicle in the automobile dealer's ending inventory.

STEP 2. For each pool, group all the invoices from Step l by item category, as defined in section 4.02(3) of this revenue procedure.

STEP 3. For each item category, add together the dealer's base vehicle costs of all vehicles within each item category, from Step 2.

STEP 4. Within each pool, compute an average base vehicle cost for each item category by dividing the result from Step 3 for each item category by the number of vehicles in the item category. This average base vehicle cost for each item will be used in Step 6 of the succeeding year's computations using the Alternative LIFO Method.

STEP 5. For each pool, compute the total current-year base vehicle cost of the pool by adding together the separate item category totals from Step 3.

STEP 6. For each pool, compute the total base vehicle cost of the ending inventory at prior-year's base vehicle cost. First, multiply the number of vehicles in the current year's ending inventory for each item category by the average base vehicle cost of the same item category from Step 4 of the preceding year's inventory calculation. If the same item was not in the prior year's ending inventory, see sections 4.02(6) and 4.02(7) of this revenue procedure. Then, add together the total prior-year base vehicle cost of all of the item categories.

STEP 7. For each pool, compute the current-year (annual) index by dividing the amount from Step 5 by the amount from Step 6.

STEP 8. For each pool, compute the cumulative index by multiplying the current-year index from Step 7 by the cumulative index at the end of the preceding year (from Step 8 of the preceding year's computation).

STEP 9. For each pool, compute the total current-year total- vehicle cost by adding together the total invoice cost, including installed options, accessories, and other inventoriable cost(s), of all the vehicles in inventory at the end of the current year.

STEP 10. For each pool, compute the total cost of the current-year's ending inventory at base-year cost by dividing the total current-year total-vehicle cost of all the vehicles in ending inventory, from Step 9, by the cumulative index from Step 8.

STEP 11. For each pool, determine if there is an increment for the current year by comparing the total cost of the pool's current-year ending inventory at base-year cost, from Step 10, with the total cost of the pool's preceding year's ending inventory at base-year cost, using the amount from Step 10 of the preceding year's calculation. If the amount from Step 10 of the current year's calculation is greater, there is an increment.

STEP 12. For each pool, value the current year's increment at current-year cost by multiplying the increment amount from Step 11 by the cumulative index from Step 8.

STEP 13. If there is no increment for a pool, but, rather, a liquidation (also referred to as a decrement), reduce the LIFO layers in reverse chronological order until the liquidation is fully absorbed.

STEP 14. For each pool, add together the current year's increment, if any, at current-year cost and the prior years' increments at each prior year's current-year cost to compute the total LIFO value for the pool.

SECTION 5. CHANGING TO ALTERNATIVE LIFO METHOD

.01 *Automatic change.* Except as provided in section 5.02 of this revenue procedure, an automobile dealer wanting to change to the Alternative LIFO Method must follow the provisions in Rev. Proc. 97–37.

.02 *Nonautomatic change.* An automobile dealer that uses the IPIC method for goods other than new automobiles, new light-duty trucks, parts and accessories, used automobiles, and used trucks, must

change to the Alternative LIFO Method under Rev. Proc. 97–27, 1997–21 I.R.B. 10.

.03 *Conditions.* An automobile dealer changing to the Alternative LIFO Method must comply with the following conditions:

(1) the automobile dealer must keep its books and records for the year of change and for later taxable years on the LIFO inventory method and use the LIFO inventory method for all reports, including consolidated financial statements, if any, and statements for credit purposes, in conformity with the provisions of § 1.472–2(e) of the regulations;

(2) the automobile dealer must value its inventory of new automobiles and new light-duty trucks as of the end of the year of change and for later taxable years under the Alternative LIFO Method, as provided in section 4 of this revenue procedure, unless it obtains permission to change to another recognized method;

(3) the automobile dealer changing from the IPIC method for its inventory of parts and accessories, used automobiles, and used trucks must value its inventory of parts and accessories, used automobiles and used trucks as of the end of the year of change and for later taxable years under the methods provided in section 10.03(2)(b) of the APPENDIX of Rev. Proc. 97–37, unless it obtains permission to change to another recognized method;

(4) the conversion from the specific goods method, if applicable, to the dollar-value method must be made in accordance with § 1.472–8(f)(2);

(5) the automobile dealer must file Form 970, Application to Use LIFO Inventory Method, with its federal income tax return for the year of change and otherwise comply with the provisions of § 472(d) and § 1.472–3 (*see also* Rev. Rul. 76–282, 1976–2 C.B. 137) to extend the LIFO election (i) to include any new automobiles and new light-duty trucks (for example, demonstrators) to which the LIFO election did not previously apply but that are required to be included in LIFO pools under the Alternative LIFO Method, and (ii) for an automobile dealer changing from the IPIC method, to include any parts and accessories, used automobiles, and used trucks, to which the LIFO election did not previously apply but that are required to be included in LIFO pools under section 10.03 of the APPENDIX to Rev. Proc. 97–37, as of the beginning of the year of change;

(6) the automobile dealer must effect the change to the Alternative LIFO Method, and in the case of an automobile dealer changing from the IPIC method to the methods provided in section 10.03(2)(b) of the APPENDIX of Rev. Proc. 97–37, using the cut-off method. Under the cut-off method, the value of the automobile dealer's new automobile and new light-duty truck inventory, and in the case of an automobile dealer changing from the IPIC method, the parts and accessories, used automobile, and used truck inventory, at the beginning of the year of change must be the same as the value of such inventory at the end of the preceding taxable year plus market value restorations, if any, required pursuant to section 5.03(5) of this revenue procedure;

(7) the automobile dealer must combine and/or separate the dollar-value inventory pool or pools, including any pool resulting from section 5.03(4) of this revenue procedure, if applicable, to conform to the inventory pooling rules provided in section 4 of this revenue procedure, and in the case of an automobile dealer changing from the IPIC method, to the inventory pooling rules provided in section 10.03(2)(b) of the APPENDIX of Rev. Proc. 97–37, in accordance with the provisions of § 1.472–8(g)(2);

(8) in effecting the changes, any layers of inventory increments previously determined and the LIFO value of such increments must be retained. Instead of using the earliest taxable year for which the automobile dealer adopted the LIFO method for any items in the inventory pool or pools, the year of change must be used as the base year in determining the LIFO value of the inventory pool or pools for the year of change and later taxable years (the cumulative index at the beginning of the year of change will be 1.00). The base-year costs of layers of increments in the pool or pools at the beginning of the year of change must be restated in terms of the new base-year costs, using the year of change as the new base year; and

(9) the automobile dealer must maintain and retain complete records of the computations of the LIFO inventory under the Alternative LIFO Method, as well as copies of the actual purchase invoice for each vehicle used in the computation.

SECTION 6. INQUIRIES

Inquiries regarding this revenue procedure may be addressed to the Commissioner of Internal Revenue, Attention: CC:DOM:IT&A, 1111 Constitution Avenue, NW, Washington, DC 20224.

SECTION 7. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 92–79, 1992–2 C.B. 457, is modified, and as modified, is superseded. However, see the transition rules in section 13.02 of Rev. Proc. 97–37.

SECTION 8. EFFECTIVE DATE

This revenue procedure is effective on August 18, 1997.

SECTION 9. ELECTING LIFO AND ADOPTING THE ALTERNATIVE LIFO METHOD

.01 *In general.* An automobile dealer that adopts the Alternative LIFO Method provided in this revenue procedure at the time the automobile dealer makes an election to use (or extend) the dollar-value LIFO inventory method must complete and file a statement of election made on a current Form 970, pursuant to the instructions for Form 970, or in such other manner as may be acceptable to the Commissioner. The use of the Alternative LIFO Method should be clearly indicated on the Form 970, or an attachment to the Form 970, and reference should be made to this revenue procedure. Appropriate LIFO sub-method elections that are an integral part of the Alternative LIFO Method, which are contained on the Form 970, must be selected on the Form 970 upon adoption of the Alternative LIFO Method.

.02 *Conditions.* A taxpayer adopting the Alternative LIFO Method must comply with the conditions stated in section 5.03(1), (2), and (9) of this revenue procedure.

SECTION 10. PAPERWORK REDUCTION ACT

The collections of information con-

tained in this revenue procedure have been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545–1551.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid OMB control number.

The collections of information in this revenue procedure are in section 5. This information is necessary and will be used to determine whether the taxpayer is properly using the Alternative LIFO Method. The collections of information are required for the taxpayer to use the Alternative LIFO Method. The likely recordkeepers are individuals, business or other for-profit institutions, and small businesses or organizations.

The estimated total annual recordkeeping burden is 200,000 hours.

The estimated annual burden per recordkeeper is 25 hours. The estimated number of recordkeepers is 8,000.

Books or records relating to a 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.

DRAFTING INFORMATION

This revenue procedure was drafted in the Office of Assistant Chief Counsel (Income Tax and Accounting). For further information regarding this revenue procedure, contact Richard H. Berken on 202-622-4970 (not a toll-free call).

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26 CFR 601.204: Changes in accounting periods and in methods of accounting.

(Also Part I, §§ 162, 165, 166, 167, 168, 197, 263, 263A, 446, 451, 454, 455, 461, 471, 472, 481, 585, 1273, 1281, 1363; 1.165–2, 1.167(e)–1, 1.263(a)–2, 1.263A–1, 1.263A–3, 1.446–1, 1.454–1, 1.455–6, 1.461–4, 1.461–5, 1.471–1, 1.471–2, 1.471–3, 1.472–6, 1.472–8, 1.481–1, 1.481–4, 1.1273–1, 1.1273–2.)

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SECTION 1. PURPOSE

This revenue procedure provides the procedures by which a taxpayer may obtain automatic consent to change the methods of accounting described in the APPENDIX of this revenue procedure. This revenue procedure consolidates and supersedes most published automatic consent guidance for changes in methods of accounting, and generally provides simplified, uniform procedures and terms and conditions to obtain automatic consent to make these changes. It also provides new automatic consent procedures for changes in several other methods of accounting. A taxpayer complying with all the applicable provisions of this revenue procedure has obtained the consent of the Commissioner of Internal Revenue to change its method of accounting under § 446(e) of the Internal Revenue Code and the Income Tax Regulations thereunder.

SECTION 2. BACKGROUND

.01 *Change in method of accounting defined.*

(1) Section 1.446–1(e)(2)(ii)(a) of the Income Tax Regulations 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, it is not necessary for the taxpayer to treat the item consistently in two or more consecutive tax returns to have adopted a method of accounting. 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 return(s). *See* Rev. Rul. 90–38, 1990–1 C.B. 57.

(3) A change in the characterization of an item may also constitute a change in method of accounting if the change has the effect of shifting income from one period to another. For example, a change from treating an item as income to treating the item as a deposit is a change in method of accounting. *See* Rev. Proc. 91–31.

(4) A change in method of accounting does not include 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). *See* § 1.446–1(e)(2)(ii)(b).

.02 *Securing permission to make a method change.* Section 446(e) and § 1.446–1(e) state that, except as otherwise provided, a taxpayer must secure the consent of the Commissioner before changing a method of accounting for federal income tax purposes. Section 1.446–1T(e)(3)(i)(B) requires that, in order to obtain the Commissioner's consent to a method change, a taxpayer must file a Form 3115, Application for Change in Accounting Method, during the taxable year in which the taxpayer wants to make the proposed change.

.03 *Terms and conditions of a method change.* Section 1.446–1(e)(3)(ii) authorizes the Commissioner to prescribe administrative procedures setting forth the limitations, terms, and conditions deemed necessary to permit a taxpayer to obtain consent to change a method of accounting in accordance with § 446(e). The terms and conditions the Commissioner may prescribe include the year of change, whether the change is to be made with a § 481(a) adjustment or on a cut-off basis, and the § 481(a) adjustment period.

.04 *No retroactive method change.* Unless specifically authorized by the Commissioner, a taxpayer may not request, or otherwise make, a retroactive change in method of accounting, regardless of whether the change is from a permissible or an impermissible method. *See generally* Rev. Rul. 90–38.

.05 *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 employed, 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 that is not required to use inventories uses the overall cash receipts and disbursements 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) *Adjustment period.* Section 481(c) and §§ 1.446–1T(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 completely in the year of change, subject to § 481(b) which limits the amount of tax where the § 481(a) adjustment is substantial. However, under the Commissioner's authority in § 1.446–1(e)(3)(ii) to prescribe terms and conditions for changes in methods of accounting, this revenue procedure provides specific adjustment periods that are intended to achieve an appropriate balance between the goals of mitigating distortions of income that result from accounting method changes and providing appropriate incentives for voluntary compliance.

.06 *Method change using a cut-off method.* The Commissioner may determine that certain changes in methods 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 (or other operative date) are accounted for under the new method of accounting. Any items arising before the year of change (or other operative date) continue to be accounted for under the taxpayer's former method of accounting. See, for example, § 263A (which generally applies to costs incurred after December 31, 1986, for noninventory property), § 461(h) (which generally applies to amounts incurred on or after July 18, 1984), and § 1.446–3 (which applies to notional principal contracts entered into on or after December 13, 1993). 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.

.07 *Consistency and clear reflection of income.* Methods of accounting should clearly reflect income on a continuing basis, and the Internal Revenue Service exercises its discretion under §§ 446(e) and 481(c) in a manner that generally minimizes distortions of income across taxable years and on an annual basis.

.08 *Separate trades or businesses.*

(1) Sections 1.446–1(d)(1) and (2) provide that when a taxpayer has two or more separate and distinct trades or businesses, a different method of accounting may be used for each trade or business provided the method of accounting used for each trade or business clearly reflects the overall income of the taxpayer as well as that of each particular trade or business. No trade or business is separate and distinct unless a complete and separable set of books and records is kept for that trade or business.

(2) Section 1.446–1(d)(3) provides that if, by reason of maintaining different methods of accounting, there is a creation or shifting of profits or losses between the trades or businesses of the taxpayer (for example, through inventory adjustments, sales, purchases, or expenses) so that income of the taxpayer is not clearly reflected, the trades or businesses of the taxpayer are not separate and distinct.

.09 *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 taxpayer does not timely file a request to change a method of accounting. See § 446(f). Additionally, the taxpayer's return preparer may also be subject to the preparer penalty under § 6694. However, penalties will not be imposed when a taxpayer changes from an impermissible method of accounting to a permissible one by complying with all applicable provisions of this revenue procedure.

.10 *Change made as part of an examination.* 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 a manner that, in the opinion of the Commissioner, does clearly reflect income. If a taxpayer under examination is not eligible to change a method of accounting under this revenue procedure, the change may be made by the district director. A change resulting in a positive § 481(a) adjustment will ordinarily be made in the earliest taxable year under examination with a one-year § 481(a) adjustment period.

SECTION 3. DEFINITIONS

.01 *Application.* The term "application" includes a Form 3115, or any statement that is authorized under the APPENDIX of this revenue procedure to be filed in lieu of a Form 3115, and any attachments.

.02 *Taxpayer.*

(1) *In general.* 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)).

(2) *Consolidated group.* For purposes of (a) sections 3.08(1), 3.09(1), and 4.02(1) of this revenue procedure (taxpayer under examination), (b) sections 3.09(2) and 4.02(2) of this revenue procedure (taxpayer before an appeals office), or (c) sections 3.09(3) and 4.02(3) of this revenue procedure (taxpayer before a federal court), the term "taxpayer" includes a consolidated group.

.03 *Filed.* Any form (including an application), statement, or other document required to be filed under this revenue procedure is filed on the date it is mailed to the proper address (or an address similar enough to complete delivery). If the form, statement, or other document is not mailed (or the date it is mailed cannot be reasonably determined), it is filed on the date it is delivered to the Service.

.04 *Mailed.* The date of mailing will be determined under the rules of § 7502. For example, the date of mailing is the date of the U.S. postmark or the applicable date recorded or marked by a designated private delivery service. *See* Notice 97–26, 1997–17 I.R.B. 6.

.05 *Timely performance of acts.* The rules of § 7503 apply when the last day for the taxpayer's timely performance of any act (for example, filing an application or submitting additional information) falls on a Saturday, Sunday, or legal holiday.

The performance of any act is timely if the act is performed on the next succeeding day that is not a Saturday, Sunday, or legal holiday.

.06 *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 to be used, even if no affected items are taken into account for that year.

.07 *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. The applicable adjustment periods are set forth in section 5.04 of this revenue procedure.

.08 *Under examination.*

(1) *In general.*

(a) Except as provided in section 3.08(2) of this revenue procedure, an examination of a taxpayer with respect to a federal income tax return begins on the date the taxpayer is contacted in any manner by a representative of the Service for the purpose of scheduling any type of examination of the return. An examination ends:

(i) in a case in which the Service accepts the return as filed, on the date of the "no change" letter sent to the taxpayer;

(ii) in a fully agreed case, on the earliest of the date the taxpayer executes a waiver of restrictions on assessment or acceptance of overassessment (for example, Form 870, 4549, or 4605), the date the taxpayer makes a payment of tax that equals or exceeds the proposed deficiency, or the date of the "closing" letter (for example, Letter 891 or 987) sent to the taxpayer; or

(iii) in an unagreed or a partially agreed case, on the earliest of the date the taxpayer (or its representative) is notified by Appeals that the case has been referred to Appeals from Examination, the date the taxpayer files a petition in the Tax Court, the date on which the period for filing a petition with the Tax Court expires, or the date of the notice of claim disallowance.

(b) An examination does not end as a result of the early referral of an issue to Appeals under the provisions of Rev. Proc. 96–9, 1996–1 C.B. 575.

(c) An examination resumes on the date the taxpayer (or its representative) is notified by Appeals (or otherwise) that the case has been referred to Examination for reconsideration.

(2) *Partnerships and S corporations subject to TEFRA.* For an entity (including a limited liability company), treated as a partnership or an S corporation for federal income tax purposes, that is subject to the TEFRA unified audit and litigation provisions for partnerships and S corporations, an examination begins on the date of the notice of the beginning of an administrative proceeding sent to the Tax Matters Partner/Tax Matters Person (TMP). An examination ends:

(a) in a case in which the Service accepts the partnership or S corporation return as filed, on the date of the "no adjustments" letter or the "no change" notice of final administrative adjustment sent to the TMP;

(b) in a fully agreed case, when all the partners, members, or shareholders execute a Form 870–P, 870–L, or 870–S; or

(c) in an unagreed or a partially agreed case, on the earliest of the date the TMP (or its representative) is notified by Appeals that the case has been referred to Appeals from Examination, the date the TMP (or a partner, member, or shareholder) requests judicial review, or the date on which the period for requesting judicial review expires.

But see section 4.02(5) of this revenue procedure for certain rules that preclude an entity from requesting a change in accounting method. Also note that S corporations are not subject to the TEFRA unified audit and litigation provisions for taxable years beginning after December 31, 1996. See Small Business Job Protection Act of 1996, Pub. L. No. 104–188, § 1317(a), 110 Stat. 1755, 1787 (1996).

.09 *Issue under consideration.*

(1) *Under examination.* A taxpayer's method of accounting for an item is an issue under consideration for the taxable years under examination if the taxpayer receives written notification (for example, by examination plan, information document request (IDR), or notification of proposed adjustments or income tax examination changes) from the examining agent(s) specifically citing the treatment of the item as an issue under consideration. For example, a taxpayer's method of pooling under the dollar-value, last-in, first-out (LIFO) inventory method is an issue under consideration as a result of an examination plan that identifies LIFO pooling as a matter to be examined, but it is not an issue under consideration as a result of an examination plan that merely identifies LIFO inventories as a matter to be examined. Similarly, a taxpayer's method of determining inventoriable costs under § 263A is an issue under consideration as a result of an IDR that requests documentation supporting the costs included in inventoriable costs, but it is not an issue under consideration as a result of an IDR that requests documentation supporting the amount of cost of goods sold reported on the return. The question of whether a method of accounting is an issue under consideration may be referred to the national office as a request for technical advice under the provisions of Rev. Proc. 97–2, 1997–1 I.R.B. 64 (or any successor).

(2) *Before an appeals office.* A taxpayer's method of accounting for an item is an issue under consideration for the taxable years before an appeals office if the treatment of the item is included as an item of adjustment in the examination report referred to Appeals or is specifically identified in writing to the taxpayer by Appeals.

(3) *Before a federal court.* A taxpayer's method of accounting for an item is an issue under consideration for the taxable years before a federal court if the treatment of the item is included in the statutory notice of deficiency, the notice of claim disallowance, the notice of final administrative adjustment, the pleadings (for example, the petition, complaint, or answer) or amendments thereto, or is specifically identified in writing to the taxpayer by the counsel for the government.

.10 *Change within the LIFO inventory method.* A change within the LIFO inventory method is a change from one LIFO inventory method or sub-method to another LIFO inventory method or sub-method. A change within the LIFO inventory method does not include a

change in method of accounting that could be made by a taxpayer that does not use the LIFO inventory method (for example, a method governed by § 471 or § 263A).

SECTION 4. SCOPE

.01 *Applicability.* Except as otherwise provided in section 4.02 of this revenue procedure, this revenue procedure applies to a taxpayer requesting the Commissioner's consent to change to a method of accounting described in the APPENDIX of this revenue procedure. Except as otherwise provided in this revenue procedure (see, for example, section 2.01 of the APPENDIX of this revenue procedure), this revenue procedure is the exclusive procedure for a taxpayer within its scope to obtain the Commissioner's consent.

.02 *Inapplicability.* Except as otherwise provided in the APPENDIX of this revenue procedure (see, for example, sections 4.01 and 12.01 of the APPENDIX of this revenue procedure), this revenue procedure does not apply in the following situations:

(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), and 6.03(4) (district director consent) of this revenue procedure;

(2) *Before an appeals office.* If, on the date the taxpayer would otherwise file a copy of the application with the national office, the taxpayer is before an appeals office with respect to any income tax issue and the method of accounting to be changed is an issue under consideration by the appeals office (as provided in section 3.09(2) of this revenue procedure);

(3) *Before a federal court.* If, on the date the taxpayer would otherwise file a copy of the application with the national office, the taxpayer is before a federal court with respect to any income tax issue and the method of accounting to be changed is an issue under consideration by the federal court (as provided in section 3.09(3) of this revenue procedure);

(4) *Consolidated group member.* A corporation that is (or was formerly) a member of a consolidated group is under examination, before an appeals office, or before a federal court (for purposes of sections 4.02(1), (2), and (3) of this revenue procedure) if the consolidated group is under examination, before an appeals office, or before a federal court for a taxable year(s) that the corporation was a member of the group;

(5) *Partnerships and S corporations.* For an entity (including a limited liability company) treated as a partnership or an S corporation for federal income tax purposes, if, on the date the entity would otherwise file a copy of the application with the national office, the entity's accounting method to be changed is an issue under consideration in an examination of a partner, member, or shareholder's federal income tax return or an issue under consideration by an appeals office or by a federal court with respect to a partner, member, or shareholder's federal income tax return;

(6) *Prior change.* If the taxpayer, within the last four taxable years prior to the year of change, (a) has made a change in the same method of accounting (with or without obtaining the Commissioner's consent) or (b) has applied to change the same method of accounting without effecting the change (whether the application to change was withdrawn, not perfected, not granted, or denied); or

(7) *Section 381(a) transaction.* If the taxpayer engages in a transaction to which § 381(a) applies within the proposed taxable year of change (determined without regard to any potential closing of the year under § 381(b)(1)).

.03 *Nonautomatic changes.* If either section 4.02(6) or 4.02(7) of this revenue procedure precludes a taxpayer from using this revenue procedure to make a change in method of accounting, the taxpayer requesting such a change must file a Form 3115 with the Commissioner in accordance with the requirements of § 1.446–1(e)(3)(i) and Rev. Proc. 97–27, 1997–21 I.R.B. 10 (or any other applicable Code, regulation, or administrative provision).

SECTION 5. TERMS AND CONDITIONS OF CHANGE

.01 *In general.* An accounting method change filed under this revenue procedure must be made pursuant to the terms and conditions provided in this revenue procedure.

.02 *Year of change.* The year of change is the taxable year designated on the application and for which the application is timely filed under section 6.02(2).

.03 *Section 481(a) adjustment.* Unless otherwise provided in this revenue procedure, a taxpayer making a change in method of accounting under this revenue procedure must take into account a § 481(a) adjustment in the manner provided in section 5.04 of this revenue procedure.

.04 *Section 481(a) adjustment period.*

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

(2) *Short period as a separate taxable year.* If the year of change, or any taxable year during the § 481(a) adjustment period, is a short taxable year, the § 481(a) adjustment must be included in income as if that short taxable year were a full 12-month taxable year. *See* Rev. Rul. 78–165, 1978–1 C.B. 276.

Example 1. A calendar year taxpayer received permission to change an accounting method beginning with the 1997 calendar year. The § 481(a) adjustment is $30,000 and the adjustment period is four taxable years. The taxpayer subsequently receives permission to change its annual accounting period to September 30, effective for the taxable year ending September 30, 1998. The taxpayer must include $7,500 of the § 481(a) adjustment in gross income for the short period from January 1, 1998, through September 30, 1998.

Example 2. Corporation *X*, a calendar year taxpayer, received permission to change an accounting method beginning with the 1997 calendar year. The § 481(a) adjustment is $30,000 and the adjustment period is four taxable years. On July 1, 1999, Corporation *Z* acquires Corporation *X* in a transaction to which § 381(a) applies. Corporation *Z* is a calendar year taxpayer that uses the same method of accounting to which Corporation *X* changed in 1997. Corporation *X* must include $7,500 of the § 481(a) adjustment in gross income for its short period income tax return for January 1, 1999, through June 30, 1999. In addition, Corporation *Z* must include $7,500 of the § 481(a) adjustment in gross income in its income tax return for calendar year 1999.

(3) *Shortened or accelerated adjustment periods.* The § 481(a) adjustment period provided in section 5.04(1) or the APPENDIX of this revenue procedure will be shortened or accelerated in the following situations.

(a) *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 if the entire § 481(a) adjustment is less than $25,000 (either positive or negative). A taxpayer makes an election under this de minimis rule by so indicating on the application. For example, for a taxpayer filing a Form 3115, the taxpayer must complete the appropriate line on the Form 3115 to elect this de minimis rule.

(b) *Cooperatives.* A cooperative within the meaning of § 1381(a) generally must take the entire amount of a § 481(a) adjustment into account in computing taxable income for the year of change. *See* Rev. Rul. 79–45, 1979–1 C.B. 284.

(c) *Ceasing to engage in the trade or business.*

(i) *In general.* A taxpayer that ceases to engage in a trade or business or terminates its existence must take the remaining balance of any § 481(a) adjustment relating to the trade or business into account in computing taxable income in the taxable year of the cessation or termination. Except as provided in sections 5.04(3)(c)(iv) and (v) of this revenue procedure, a taxpayer is treated as ceasing to engage in a trade or business if the operations of the trade or business cease or substantially all the assets of the trade or business are transferred to another taxpayer. For this purpose, "substantially all" has the same meaning as in section 3.01 of Rev. Proc. 77–37, 1977–2 C.B. 568.

(ii) *Examples of transactions that are treated as the cessation of a trade or business.* The following is a nonexclusive list of transactions that are treated as the cessation of a trade or business for purposes of accelerating the § 481(a) adjustment under section 5.04(3)(c) of this revenue procedure:

(A) the trade or business to which the § 481(a) adjustment relates is incorporated;

(B) the trade or business to which the § 481(a) adjustment relates is purchased by another taxpayer in a transaction to which § 1060 applies;

(C) the trade or business to which the § 481(a) adjustment relates is terminated or transferred pursuant to a taxable liquidation;

(D) a division of a corporation ceases to operate the trade or business to which the § 481(a) adjustment relates; or

(E) the assets of a trade or business to which the § 481(a) adjustment relates are contributed to a partnership.

(iii) *Conversion to or from S corporation status.* Except as provided in section 10.01 of the APPENDIX of this revenue procedure, no acceleration of a § 481(a) adjustment is required under section 5.04(3)(c) of this revenue procedure when a C corporation elects to be treated as an S corporation or an S corporation terminates its S election and is then treated as a C corporation.

(iv) *Certain transfers to which § 381(a) applies.* No acceleration of the § 481(a) adjustment is required under section 5.04(3)(c) of this revenue procedure when a taxpayer transfers substantially all the assets of the trade or business that gave rise to the § 481(a) adjustment to another taxpayer in a transfer to which § 381(a) applies and the accounting method (the change to which gave rise to the § 481(a) adjustment) is a tax attribute that is carried over and used by the acquiring corporation immediately after the transfer pursuant to § 381(c). The acquiring corporation is subject to any terms and conditions imposed on the transferor (or any predecessor of the transferor) as a result of its change in method of accounting.

(v) *Certain transfers pursuant to § 351 within a consolidated group.*

(A) *In general.* No acceleration of the § 481(a) adjustment is required under section 5.04(3)(c) of this revenue procedure when one member of an affiliated group filing a consolidated return transfers substantially all the assets of the trade or business that gave rise to the § 481(a) adjustment to another member of the same consolidated group in an exchange qualifying under § 351 and the transferee member adopts and uses the same method of accounting (the change to which gave rise to the § 481(a) adjustment) used by the transferor member. The transferor member must continue to take the § 481(a) adjustment into account pursuant to the terms and conditions set forth in this revenue procedure. The transferor member must take into account activities of the transferee member (or any successor) in determining whether acceleration of the § 481(a) adjustment is required. For example, except as provided in the following sentence, the transferor member must take any remaining § 481(a) adjustment into account in computing taxable income in the taxable year in which the transferee member ceases to engage in the trade or business to which the § 481(a) adjustment relates. The § 481(a) adjustment is not accelerated when the transferee member engages in a transaction described in section 5.04(3)(c)(iv) or 5.04(3)(c)(v)(A) of this revenue procedure.

(B) *Exception.* The provisions of section 5.04(3)(c)(v)(A) of this revenue procedure cease to apply and the transferor member must take any remaining balance of the § 481(a) adjustment into account in the taxable year immediately preceding any of the following: (1) the taxable year the transferor member ceases to be a member of the group; (2) the taxable year any transferee member owning substantially all the assets of the trade or business which gave rise to the § 481(a) adjustment ceases to be a member of the group; or (3) a separate return year of the common parent of the group. In applying the preceding sentence, the rules of paragraphs (j)(2), (j)(5), and (j)(6) of § 1.1502–13 apply, but only if the method of accounting to which the transferor member changed and to which the § 481(a) adjustment relates is adopted, carried over, or used by any transferee member acquiring the assets of the trade or business that gave rise to the § 481(a) adjustment immediately after acquisition of such assets. For example, the transferor member is not required to accelerate the § 481(a) adjustment if a transferee member ceases to be a member of a consolidated group by reason of an acquisition to which § 381(a) applies and the acquiring corporation (1) is a member of the same group as the transferor member, and (2) continues, under § 381(c)(4) and the regulations thereunder, to use the same method of accounting as that used by the transferor member with respect to the assets of the trade or business to which the § 481(a) adjustment relates.

.05 *NOL carryback limitation for taxpayer subject to criminal investigation.* Generally, no portion of any net operating loss that is attributable to a negative § 481(a) adjustment may be carried back to a taxable year prior to the year of change that is the subject of any pending or future criminal investigation or proceeding con-

cerning (1) directly or indirectly, any issue relating to the taxpayer's federal tax liability, or (2) the possibility of false or fraudulent statements made by the taxpayer with respect to any issue relating to its federal tax liability.

.06 *Change treated as initiated by the taxpayer.* For purposes of § 481, a change in method of accounting made under this revenue procedure is a change in method of accounting initiated by the taxpayer.

SECTION 6. GENERAL APPLICATION PROCEDURES

.01 *Consent.* Pursuant to § 1.446–1(e)(2)(i), the consent of the Commissioner is hereby granted to any taxpayer within the scope of this revenue procedure to change a method of accounting, provided the taxpayer complies with all the applicable provisions of this revenue procedure.

.02 *Filing requirements.*

(1) *Waiver of taxable year filing requirement.* The requirement under § 1.446–1T(e)(3)(i)(B) to file a Form 3115 within the taxable year for which the change is requested is waived for any application for a change in method of accounting filed pursuant to this revenue procedure. See § 1.446–1(e)(3)(ii).

(2) *Timely duplicate filing requirement.*

(a) *In general.* A taxpayer changing a method of accounting pursuant to this revenue procedure must complete and file an application in duplicate. The original must be attached to the taxpayer's timely filed (including extensions) original federal income tax return for the year of change. A copy of the application must be filed with the national office (see section 6.02(6) of this revenue procedure for the address) no earlier than the first day of the year of change and no later than when the original is filed with the federal income tax return for the year of change.

(b) *Limited relief for late application.* A taxpayer that fails to file the application for the year of change as provided in section 6.02(2)(a) of this revenue procedure will not be granted an extension of time to file under § 301.9100 of the Procedure and Administration Regulations, except in unusual and compelling circumstances. *See* § 301.9100–3T(c)(2).

(3) *Label.*

(a) In order to assist in processing an application under this revenue procedure, the section of the APPENDIX of this revenue procedure describing the specific change in method of accounting should be included in the application. For example, a phrase such as "Section 1.01 of the APPENDIX of Rev. Proc. 97–37" should be included on the appropriate line on the Form 3115.

(b) If a taxpayer is authorized under the APPENDIX of this revenue procedure to file a statement in lieu of a Form 3115, the taxpayer must include the taxpayer's name and employer identification number (or social security number in the case of an individual) at the top of the first page of the statement underneath any other required label.

(4) *Signature requirements.* The application must be signed by, or on behalf of, the taxpayer requesting the change by an individual with authority to bind the taxpayer in such matters. For example, an officer must sign on behalf of a corporation, a general partner on behalf of a state law partnership, a member-manager on behalf of a limited liability company, a trustee on behalf of a trust, or an individual taxpayer on behalf of a sole proprietorship. If the taxpayer is a member of a consolidated group, an application submitted on behalf of the taxpayer must be signed by a duly authorized officer of the common parent. See the signature requirements set forth in the General Instructions attached to a current Form 3115 regarding those who are to sign. If an agent is authorized to represent the taxpayer before the Service, receive the original or a copy of the correspondence concerning the application, or perform any other act(s) regarding the application filed on behalf of the taxpayer, a power of attorney reflecting such authorization(s) must be attached to the application. A taxpayer's representative without a power of attorney to represent the taxpayer as indicated in this section will not be given any information regarding the application.

(5) *Additional statement required.* In addition to providing all the information that is required by the application, a taxpayer must attach to the application a written statement providing as follows:

(a) the taxpayer agrees to all of the terms and conditions in this revenue procedure; and

(b) if a § 481(a) adjustment is required, the reason for claiming the § 481(a) adjustment period over which the taxpayer agrees to take the applicable § 481(a) adjustment into account.

(6) *Where to file.* A taxpayer, other than an exempt organization, changing a method of accounting pursuant to this revenue procedure must file a copy of the application with the national office addressed to the Commissioner of Internal Revenue, Attention: CC:DOM:IT&A, P.O. Box 7604, Benjamin Franklin Station, Washington, DC 20044 (or, in the case of a designated private delivery service: Commissioner of Internal Revenue, Attention: CC:DOM:IT&A, 1111 Constitution Avenue, NW, Washington, DC 20224). An exempt organization must address the application to the Assistant Commissioner (Employee Plans and Exempt Organizations), Attention: E:EO, P.O. Box 120, Benjamin Franklin Station, Washington, DC 20044 (or, in the case of a designated private delivery service: Assistant Commissioner (Employee Plans and Exempt Organizations), Attention: E:EO, 1111 Constitution Avenue, NW, Washington, DC 20224).

(7) *No user fee.* A user fee is not required for an application filed under this revenue procedure, and the receipt of an application filed under this revenue procedure will not be acknowledged.

(8) *Single application for certain consolidated groups.* A parent corporation may file a single application to change an identical method of accounting on behalf of more than one member of a consolidated group. To qualify, the taxpayers in the consolidated group must be members of the same affiliated group under § 1504(a) that join in the filing of a consolidated tax return, and they must be changing from the identical present method of accounting to the identical proposed method of accounting. All aspects of the change in method of accounting, including the present and proposed methods, the underlying facts, and the authority for the change, must be identical, except for the § 481(a) adjustment. *See* section 15.07(3) of Rev. Proc. 97–1, 1997–1 I.R.B. at 49 (or any successor), for the information required to be submitted with the application.

.03 *Taxpayer under examination.*

(1) *In general.* Except as otherwise provided in the APPENDIX of this rev-

enue procedure (see, for example, sections 4.01 and 12.01 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 if the taxpayer is within the provisions of section 6.03(2) (90-day window), 6.03(3) (120-day window), or 6.03(4) (district director consent) of this revenue procedure. A taxpayer that files an application 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.

(2) *90-day window period.*

(a) A taxpayer may file a copy of the application with the national office to change a method of accounting under this revenue procedure during the first 90-days of any taxable year (the "90-day window") if the taxpayer has been under examination for at least 12 consecutive months as of the first day of the taxable year. This 90-day window is not available if the method of accounting the taxpayer is changing is an issue under consideration at the time the copy of the application is filed or an issue the examining agent(s) has placed in suspense at the time the copy of the application is filed.

(b) A taxpayer changing a method of accounting under this 90-day window must provide a copy of the application to the examining agent(s) at the same time it files the copy of the application with the national office. The application must contain the name(s) and telephone number(s) of the examining agent(s). The taxpayer must attach to the application a separate statement signed by the taxpayer certifying that, to the best of the taxpayer's knowledge, the same method of accounting is not an issue under consideration or an issue placed in suspense by the examining agent(s).

(3) *120-day window period.*

(a) A taxpayer may file a copy of the application with the national office to change a method of accounting under this revenue procedure during the 120-day period following the date an examination ends (the "120-day window"), regardless of whether a subsequent examination has commenced. This 120-day window is not available if the method of accounting the taxpayer is changing is an issue under consideration at the time a copy of the application is filed or an issue the examining agent(s) has placed in suspense at the time the copy of the application is filed.

(b) A taxpayer changing a method of accounting under this 120-day window must provide a copy of the application to the examining agent(s) for any examination that is in process at the same time it files the copy of the application with the national office. The application must contain the name(s) and telephone number(s) of the examining agent(s). The taxpayer must attach to the application a separate statement signed by the taxpayer certifying that, to the best of the taxpayer's knowledge, the same method of accounting is not an issue under consideration or an issue placed in suspense by the examining agent(s).

(4) *Consent of district director.*

(a) A taxpayer under examination may change its method of accounting under this revenue procedure if the district director consents to the change. The district director will consent to the change unless, in the opinion of the district director, the method of accounting to be changed would ordinarily be included as an item of adjustment in the year(s) for which the taxpayer is under examination. For example, the district director will consent to a change from a clearly permissible method of accounting. The district director will also consent to a change from an impermissible method of accounting where the impermissible method was adopted subsequent to the years under examination. The question of whether the method of accounting from which the taxpayer is changing is permissible or was adopted subsequent to the years under examination may be referred to the national office as a request for technical advice under the provisions of Rev. Proc. 97–2 (or any successor).

(b) A taxpayer changing a method of accounting under this revenue procedure with the consent of the district director must attach to the application a statement from the district director consenting to the change. The taxpayer must provide a copy of the application to the district director at the same time it files a copy of the application with the national office. The application must contain the name(s) and telephone number(s) of the examining agent(s).

.04 *Taxpayer before an appeals office.* A taxpayer that is before an appeals office must attach to the application a separate statement signed by the taxpayer certifying that, to the best of the taxpayer's knowledge, the same method of accounting is not an issue under consideration by the appeals office. The taxpayer must provide a copy of the application to the appeals officer at the same time it files a copy of the application with the national office. The application must contain the name and telephone number of the appeals officer.

.05 *Taxpayer before a federal court.* A taxpayer that is before a federal court must attach to the application a separate statement signed by the taxpayer certifying that, to the best of the taxpayer's knowledge, the same method of accounting is not an issue under consideration by the federal court. The taxpayer must provide a copy of the application to the counsel for the government at the same time it files a copy of the application with the national office. The application must contain the name and telephone number of the counsel for the government.

.06 *Compliance with provisions.* If a taxpayer to which this revenue procedure applies changes to a method of accounting without complying with all the applicable provisions of this revenue procedure (for example, the taxpayer changes to a method of accounting that varies from the applicable accounting method described in this revenue procedure or the taxpayer is outside the scope of this revenue procedure), the taxpayer has initiated a change in method of accounting without obtaining the consent of the Commissioner as required by § 446(e). Upon examination, a taxpayer that has initiated an unauthorized change in method of accounting may be required to effect the change in an earlier or later taxable year and may be denied the benefit of spreading the § 481(a) adjustment over the number of taxable years otherwise prescribed by this revenue procedure.

SECTION 7. AUDIT PROTECTION FOR TAXABLE YEARS PRIOR TO YEAR OF CHANGE

.01 *In general.* Except as provided in section 7.02 or the APPENDIX of this

revenue procedure, when a taxpayer timely files a copy of the application with the national office in compliance with all the applicable provisions of this revenue procedure, the Service will not require the taxpayer to change its method of accounting for the same item for a taxable year prior to the year of change.

.02 *Exceptions.*

(1) *Change not made or made improperly.* The Service may change a taxpayer's method of accounting for prior taxable years if (a) the taxpayer fails to implement the change; (b) the taxpayer implements the change but does not comply with all the applicable provisions of this revenue procedure, or (c) the method of accounting is changed or modified because there has been a misstatement or omission of material facts (*see* section 8.02(2) of this revenue procedure).

(2) *Change in sub-method.* The Service may change a taxpayer's method of accounting for prior taxable years if the taxpayer is changing a sub-method of accounting within the method. For example, an examining agent may propose to terminate the taxpayer's use of the LIFO inventory method during a prior taxable year even though the taxpayer changes its method of valuing increments in the current year.

(3) *Prior year Service-initiated change.* The Service may make adjustments to the taxpayer's returns for the same item for taxable years prior to the requested year of change to reflect a prior year Service-initiated change.

(4) *Criminal investigation.* The Service may change a taxpayer's method of accounting for the same item for taxable years prior to the year of change if there is any pending or future criminal investigation or proceeding concerning (a) directly or indirectly, any issue relating to the taxpayer's federal tax liability for any taxable year prior to the year of change, or (b) the possibility of false or fraudulent statements made by the taxpayer with respect to any issue relating to its federal tax liability for any taxable year prior to the year of change.

SECTION 8. EFFECT OF CONSENT

.01 *In general.* A taxpayer that changes to a method of accounting pursuant to this revenue procedure may be required to change or modify that method of accounting for the following reasons:

(1) the enactment of legislation;

(2) a decision of the United States Supreme Court;

(3) the issuance of temporary or final regulations;

(4) the issuance of a revenue ruling, revenue procedure, notice, or other statement published in the Internal Revenue Bulletin;

(5) the issuance of written notice to the taxpayer that the change in method of accounting was not in compliance with all the applicable provisions of this revenue procedure or is not in accord with the current views of the Service; or

(6) a change in the material facts on which the consent was based.

.02 *Retroactive change or modification.* Except in rare or unusual circumstances, if a taxpayer that changes its method of accounting under this revenue procedure is subsequently required under section 8.01 of this revenue procedure to change or modify that method of accounting, the required change or modification will not be applied retroactively, provided that:

(1) the taxpayer complied with all the applicable provisions of this revenue procedure;

(2) there has been no misstatement or omission of material facts;

(3) there has been no change in the material facts on which the consent was based;

(4) there has been no change in the applicable law; and

(5) the taxpayer to whom consent was granted acted in good faith in relying on the consent, and applying the change or modification retroactively would be to the taxpayer's detriment.

SECTION 9. REVIEW BY DISTRICT DIRECTOR

.01 *In general.* The district director must apply a change in method of accounting made in compliance with all the applicable provisions of this revenue procedure in determining the taxpayer's liability, unless the district director recommends that the change in method of accounting should be modified or revoked. (See section 6.06 of this revenue procedure if a change in method of accounting is made without complying with all the applicable provisions of this revenue procedure.) The district director will ascertain if:

(1) the representations on which the change was based reflect an accurate statement of the material facts;

(2) the amount of the § 481(a) adjustment was properly determined;

(3) the change in method of accounting was implemented in compliance with all the applicable provisions of this revenue procedure;

(4) there has been any change in the material facts on which the change was based during the period the method of accounting was used; and

(5) there has been any change in the applicable law during the period the method of accounting was used.

.02 *National office consideration.* If the district director recommends that a change in method of accounting (other than the § 481(a) adjustment) made in compliance with all the applicable provisions of this revenue procedure should be modified or revoked, the district director will forward the matter to the national office for consideration before any further action is taken. Such a referral to the national office will be treated as a request for technical advice, and the provisions of Rev. Proc. 97–2 (or any successor) will be followed.

SECTION 10. REVIEW BY NATIONAL OFFICE

.01 *In general.* Any application filed under this revenue procedure may be reviewed by the national office. If the application is reviewed by the national office, the procedures in sections 10.02 through 10.04 of this revenue procedure apply.

.02 *Incomplete application—21 day rule.* If the Service reviews an application and determines that the application is not properly completed in accordance with the instructions of the Form 3115 or the provisions of this revenue procedure, or if supplemental information is needed, the Service will notify the taxpayer. The notification will specify the information that needs to be provided, and the taxpayer will be permitted 21 days from the date of the notification to furnish the necessary information. The Service reserves the right to impose shorter reply periods if subsequent requests for additional infor-

mation are made. An extension of the 21-day period to furnish information, not to exceed 15 days, may be granted to a taxpayer. A request for an extension of the 21-day period must be made in writing and submitted within the 21-day period. If the extension request is denied, there is no right of appeal.

.03 *Conference in the national office.* If the national office tentatively determines that the taxpayer has changed its method of accounting without complying with all the applicable provisions of this revenue procedure (for example, the taxpayer changed to a method of accounting that varies from the applicable accounting method described in this revenue procedure or the taxpayer is outside the scope of this revenue procedure), the national office will notify the taxpayer of its tentative adverse determination and will offer the taxpayer a conference of right, if the taxpayer has requested a conference. For conference procedures for taxpayers other than exempt organizations, see section 11 of Rev. Proc. 97–1 (or any successor). For conference procedures for exempt organizations, see section 12 of Rev. Proc. 97–4, 1997–1 I.R.B. 96 (or any successor).

.04 *National office determination.* If the national office determines that the taxpayer has changed its method of accounting without complying with all the applicable provisions of this revenue procedure, the national office will notify the taxpayer that consent to make the change in method of accounting either (1) is not granted, or (2) is granted, provided the taxpayer makes appropriate adjustments to conform its change in method of accounting to the applicable provisions of this revenue procedure. Any adjustments so made must be accompanied by conforming amendments to any federal income tax returns filed for the year of change and subsequent taxable years.

SECTION 11. APPLICABILITY OF REV. PROCS. 97–1 AND 97–4

Rev. Procs. 97–1 and 97–4 (or any successors) are applicable to applications filed under this revenue procedure, unless specifically excluded or overridden by other published guidance (including the special procedures in this document).

SECTION 12. INQUIRIES

Inquiries regarding this revenue procedure may be addressed to the Commissioner of Internal Revenue, Attention: CC:DOM:IT&A, 1111 Constitution Avenue, NW, Washington, DC 20224.

SECTION 13. EFFECTIVE DATE

.01 *In general.* Except as provided in sections 13.02 and 13.03 of this revenue procedure, this revenue procedure is effective for taxable years ending on or after August 18, 1997. Except as provided in sections 13.02 and 13.03 of this revenue procedure, the Service will return any application that is filed on or after August 18, 1997, if the application is filed with the national office pursuant to the Code, regulations, or administrative guidance other than this revenue procedure and the change in method of accounting is within the scope of this revenue procedure.

.02 *Transition rules.*

(1) *Previously filed applications.*

(a) *Applications for advance consent.* If a taxpayer filed an application with the national office under Rev. Proc. 97–27 or Rev. Proc. 92–20, 1992–1 C.B. 685, to make a change in method of accounting authorized by this revenue procedure, and the application is pending with the national office on August 18, 1997, the taxpayer may make the change under this revenue procedure. However, the national office will process the application in accordance with the revenue procedure under which the application was filed, unless prior to the later of September 30, 1997, or the issuance of the letter ruling granting or denying consent to the change, the taxpayer notifies the national office that it wants to make the change under this revenue procedure. If the taxpayer timely notifies the national office that it wants to make the method change under this revenue procedure, the national office will require the taxpayer to make appropriate modifications to the application to comply with the applicable provisions of this revenue procedure. In addition, any user fee that was submitted with the application will be returned to the taxpayer.

(b) *Applications for automatic consent.* If a taxpayer filed an application with the national office (or a service center) previously authorized by an automatic consent procedure listed in section 14.01 of this revenue procedure, before August 18, 1997, to make a change in method of accounting authorized by this revenue procedure, the taxpayer may make the change under this revenue procedure. However, the national office will process the application in accordance with the automatic consent procedure under which the application was filed, unless prior to September 30, 1997, the taxpayer notifies the national office in writing (at the address provided in section 6.02(6) of this revenue procedure) that it wants to make the change under this revenue procedure. If the taxpayer timely notifies the national office that it wants to make the method change under this revenue procedure, the national office will require the taxpayer to make appropriate modifications to the application to comply with the applicable provisions of this revenue procedure.

(2) *New applications.*

(a) *Prior automatic consent procedures.* A taxpayer that wants to make a change in method of accounting previously authorized by an automatic consent procedure listed in section 14.01 of this revenue procedure, for a taxable year that ends on or after August 18, 1997, may make the change under that automatic consent procedure by complying with that procedure and the following additional filing requirement. In lieu of filing the application with the national office (or a service center) pursuant to that automatic consent procedure, the taxpayer must file a copy of the application with the national office no earlier than the first day of the year of change, and no later than the earlier of December 31, 1997, or when the original application is filed with the timely filed original federal income tax return (including extensions) for the year of change. A taxpayer changing its method of accounting under Rev. Proc. 85–8, 1985–1 C.B. 495, for a taxable year ending on or before December 31, 1997, may file under that revenue procedure. The additional filing requirement described above does not apply to this change.

(b) *New automatic consent procedures.* A taxpayer making a change in method of accounting authorized by this revenue procedure, other than a change

previously authorized by an automatic consent procedure listed in section 14.01 of this revenue procedure or a change authorized by section 13.01 of the APPENDIX of this revenue procedure, that files a copy of an application under the provisions of this revenue procedure no later than the earlier of December 31, 1997, or when the original application is filed with the timely filed original federal income tax return (including extensions) for the year of change, may apply the § 481(a) adjustment period determined under sections 5 and 8 of Rev. Proc. 92–20. The taxpayer must affirmatively state in an attachment to the application (a) that it requests to apply the § 481(a) adjustment period determined under sections 5 and 8 of Rev. Proc. 92–20, and (b) the applicable § 481(a) adjustment period and the authority therefor.

.03 *Timing of incurring liabilities for payroll taxes.* To change a method of accounting under section 8.04 of the APPENDIX of this revenue procedure, a taxpayer may use the provisions of this revenue procedure for taxable years ending on or after October 21, 1996.

SECTION 14. EFFECT ON OTHER DOCUMENTS

.01 *Modified and superseded.* Rev. Procs. 96–31, 1996–1 C.B. 714; 95–33, 1995–2 C.B. 380; 94–29, 1994–1 C.B. 616; 92–98, 1992–2 C.B. 512; 92–97, 1992–2 C.B. 510; 92–79, 1992–2 C.B. 457; 92–75, 1992–2 C.B. 448; 92–74, 1992–2 C.B. 442; 90–63, 1990–2 C.B. 664; 90–37, 1990–2 C.B. 361; 89–46, 1989–2 C.B. 597; 88–15, 1988–1 C.B. 683; 84–76, 1984–2 C.B. 751; and 74–11, 1974–1 C.B. 420; and Notice 95–57, 1995–2 C.B. 337; are modified, and as modified, are superseded.

.02 *Obsoleted.* The following revenue procedures are obsoleted:

(1) Rev. Proc. 85–8, 1985–1 C.B. 495 (a revenue procedure that allows a taxpayer to change its method of accounting for bad debts);

(2) Rev. Proc. 84–30, 1984–1 C.B. 482 (a revenue procedure that allows a taxpayer to change its method of accounting for interest on certain consumer loans from the Rule of 78's method to the economic accrual method);

(3) Rev. Proc. 84–29, 1984–1 C.B. 480 (a revenue procedure that provides a simplified procedure for an individual borrower to use to compute interest deductions for certain loans if the taxpayer has been reporting interest deductions on these loans based on the Rule of 78's method);

(4) Rev. Proc. 84–28, 1984–1 C.B. 475 (a revenue procedure that allows a taxpayer to change its method of accounting for interest from the Rule of 78's method to the economic accrual method, but only for those loans in which the interest computed using the Rule of 78's method exceeds the loan payments during any year of the term of the loan);

(5) Rev. Proc. 84–27, 1984–1 C.B. 469 (a revenue procedure that allows a taxpayer to change its method of accounting for interest from the Rule of 78's method to the economic accrual method); and

(6) Rev. Proc. 83–40, 1983–1 C.B. 774 (a revenue procedure that allows a taxpayer to use the Rule of 78's method to compute interest on certain short-term consumer loans).

SECTION 15. PAPERWORK REDUCTION ACT

The collections of information contained in this revenue procedure have been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545–1551.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid OMB control number.

The collections of information in this revenue procedure are in sections 6, 10, 13, and sections 2, 3, 5, 6, 7, 10, and 12 of the APPENDIX. This information is necessary and will be used to determine whether the taxpayer properly changed to a permitted method of accounting. The collections of information are required for the taxpayer to obtain consent to change its method of accounting. The likely respondents are the following: individuals, farms, business or other for-profit institutions, nonprofit institutions, and small businesses or organizations.

The estimated total annual reporting and/or recordkeeping burden is 5,464 hours.

The estimated annual burden per respondent/recordkeeper varies from 1/10 hour to 5 7/10 hours, depending on individual circumstances, with an estimated average of 1 1/2 hours. The estimated number of respondents is 2,000.

The estimated annual frequency of responses is on occasion.

Books or records relating to a 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.

DRAFTING INFORMATION

The principal author of this revenue procedure is Dwight N. Mersereau of the Office of Assistant Chief Counsel (Income Tax and Accounting). For further information regarding this revenue procedure, contact the following individuals: (1) for changes in methods of accounting under sections 2.01 and 2.02 of the APPENDIX of this revenue procedure, Peter Friedman of the Office of Assistant Chief Counsel (Passthroughs and Special Industries) on (202) 622-3110 (not a toll-free call); (2) for changes in methods of accounting under sections 6 and 11 of the APPENDIX of this revenue procedure, Nicholas Bogos of the Office of Assistant Chief Counsel (Financial Institutions and Products) on (202) 622-3920 (not a toll-free call); (3) for changes in methods of accounting under sections 12 and 13 of the APPENDIX of this revenue procedure, William Blanchard of the Office of Assistant Chief Counsel (Financial Institutions and Products) on (202) 622-3950 (not a toll-free call); and (4) for all other matters, Mr. Mersereau on (202) 622-4970 (not a toll-free call).

APPENDIX

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SECTION 1. TRADE OR BUSINESS EXPENSES (§ 162)

.01 *Advances made by a lawyer on behalf of clients — Description of change and scope*. This change applies to a lawyer handling cases on a contingent fee basis that advances money to pay for costs of litigation or for other expenses on behalf of clients and that wants to change the method of accounting for such advances from treating them as deductible business expenses to treating them as loans. *See Boccardo v. United States,* 12 Cl. Ct. 184 (1987); *Canelo v. Commissioner,* 53 T.C. 217 (1969), *aff'd per curiam,* 447 F.2d 484 (9th Cir. 1971).

.02 *Reserved.*

SECTION 2. DEPRECIATION OR AMORTIZATION (§ 167, 168, OR 197)

.01 *Claiming less than the depreciation or amortization allowable.*

(1) *Description of change.*

(a) This change applies to a taxpayer that wants to change from an impermissible method of accounting for depreciation or amortization (depreciation) under which the taxpayer claimed less than the depreciation allowable, to a permissible method of accounting for depreciation under which the taxpayer will claim the depreciation allowable. The taxpayer has the option of either making the change in method of accounting under this revenue procedure or requesting permission to make the change under Rev. Proc. 97–27, 1997–21 I.R.B. 10. This change was formerly provided in Rev. Proc. 96–31, 1996–1 C.B. 714.

(b) A change from a taxpayer's impermissible method of accounting for depreciation under which the taxpayer did not claim the depreciation allowable to a permissible method of accounting for depreciation under which the taxpayer will claim the depreciation allowable is a change in method of accounting for which the consent of the Commissioner is required. Sections 1.167(e)–1(a) and 1.446–1(e)(2)(ii)(b). This method change, however, does not include any correction of mathematical or posting errors. Section 1.446–1(e)(2)-(ii)(b).

(2) *Scope.*

(a) *Applicability.* Except as provided in section 2.01(2)(b) of this APPENDIX, this change applies to any taxpayer that has used an impermissible method of accounting for depreciation in at least the two taxable years immediately preceding the year of change, and is changing that accounting method to a permissible method of accounting for depreciation, for any item of property:

(i) for which, under the taxpayer's impermissible method of accounting, the taxpayer has not taken into account any depreciation allowance or has taken into account some depreciation but less than the depreciation allowable (claimed less than the depreciation allowable);

(ii) for which depreciation is determined under § 167, 168, 197, or 168 prior to its amendment in 1986 (former § 168); and

(iii) that is owned by the taxpayer at the beginning of the year of change.

(b) *Inapplicability.* This change does not apply to:

(i) any property to which § 1016(a)(3) (regarding property held by a tax-exempt organization) applies;

(ii) any taxpayer that is subject to § 263A and that is required to capitalize the costs with respect to which the taxpayer wants to change its method of accounting under section 2.01 of this APPENDIX, if the taxpayer is not capitalizing the costs as required;

(iii) any intangible property subject to § 167, except for property subject to § 167(f) (regarding certain property excluded from § 197);

(iv) any property subject to § 167(g) (regarding property depreciated under the income forecast method);

(v) any § 1250 property that a taxpayer is reclassifying to an asset class of Rev. Proc. 87–56, 1987–2 C.B. 674, or Rev. Proc. 83–35, 1983–1 C.B. 745, as appropriate, that does not explicitly include § 1250 property (for example, asset class 57.0, Distributive Trades and Services);

(vi) any property for which a taxpayer is revoking a timely valid election, or making a late election, under § 167, 168, former § 168, or § 13261(g)(2) or (3) of the Revenue Reconciliation Act of 1993 (1993 Act), 1993–3 C.B. 1, 128 (relating to amortizable § 197 intangibles). A taxpayer may request consent to revoke or make the election by submitting a request for a letter ruling under Rev. Proc. 97–1, 1997–1 I.R.B. 11 (or any successor);

(vii) any property subject to § 167 (other than § 167(f), regarding certain property excluded from § 197), for which a taxpayer is changing only the estimated useful life of the property. A change in the estimated useful life of property for which depreciation is determined under § 167 (other than § 167(f)) must be made prospectively (*see*, for example, § 1.167(b)–2(c)) (In contrast, section 2.01 of this APPENDIX generally applies to a change in the recovery period of property for which depreciation is determined under § 168 or former § 168);

(viii) any depreciable property that changes use but continues to be owned by the same taxpayer (*see*, for ex-

ample, § 168(i)(5));

(ix) any property for which a taxpayer has claimed depreciation in excess of the depreciation allowable;

(x) any change in method of accounting involving a change from deducting the cost or other basis of any property as an expense to capitalizing and depreciating the cost or other basis;

(xi) any change in method of accounting involving a change from one permissible method of accounting for the property to another permissible method of accounting for the property. For example:

(A) a change from the straight-line method of depreciation to the income forecast method of depreciation for videocassettes. *See* Rev. Rul. 89–62, 1989–1 C.B. 78;

(B) a change in the classification of a retail motor fuels outlet placed in service before August 20, 1996, from nonresidential real property to 15–year property under § 168 (see Rev. Proc. 97–10, 1997–2 I.R.B. 59, for the exclusive procedures for making this change); or

(C) a change from charging the depreciation reserve with costs of removal and crediting the depreciation reserve with salvage proceeds to deducting costs of removal as an expense (provided the costs of removal are not required to be capitalized under any provision of the Code, such as, § 263(a)) and including salvage proceeds in taxable income (see section 2.02 of this APPENDIX for making this change for property for which depreciation is determined under § 167); or

(xii) any change in method of accounting for an item of income or deduction other than depreciation, even if a taxpayer's present method of accounting may have resulted in the taxpayer claiming less than the depreciation allowable. For example, a change in method of accounting involving:

(A) a change in inventory costs (for example, when property is reclassified from inventory property to depreciable property); or

(B) a change in the character of a transaction from sale to lease (see section 2.03 of this APPENDIX for making this change).

(3) *Taxpayer with under- and over-depreciated properties.*

(a) Because this revenue procedure is not the exclusive procedure to change a method of accounting to which section 2.01 of this APPENDIX applies, a taxpayer that wants to change a method of accounting for depreciation to which section 2.01 of this APPENDIX applies on some items of property and to change an impermissible method of accounting for depreciation under which the taxpayer claimed more than the depreciation allowable on other items of property, may file:

(i) one application under Rev. Proc. 97–27 for both the under- and over-depreciated properties; or

(ii) two applications—one application under this revenue procedure for the under-depreciated property and one application under Rev. Proc. 97–27 for the over-depreciated property.

(b) In either situation, the omitted depreciation for the under-depreciated property and the excess depreciation for the over-depreciated property from taxable years prior to the year of change will be taken into account through a § 481(a) adjustment.

(4) *Additional requirements.* A taxpayer also must comply with the following:

(a) *Permissible depreciation method.* A taxpayer must change to a permissible method of accounting for depreciation for the item of property. This method is the same method that determines the depreciation allowable for the item of property (as provided in section 2.01(7) of this APPENDIX).

(b) *Statements required.* A taxpayer must provide the following statements, if applicable, and attach them to the completed application:

(i) a detailed description of the former and new methods of accounting. A general description of these methods of accounting is unacceptable (for example, MACRS to MACRS or erroneous method to proper method);

(ii) to the extent not provided elsewhere on the application, a statement describing the taxpayer's business or income-producing activities. Also, if the taxpayer has more than one business or income-producing activity, a statement describing the taxpayer's business or income-producing activity in which the item of property at issue is primarily used by the taxpayer;

(iii) to the extent not provided elsewhere on the application, a statement of the facts and law supporting the new method of accounting, new classification of the item of property, and new asset class in, as appropriate, Rev. Proc. 87–56 or Rev. Proc. 83–35. If the taxpayer is the owner and lessor of the item of property at issue, the statement of the facts and law supporting the new asset class also must describe the business or income-producing activity in which that item of property is primarily used by the lessee;

(iv) to the extent not provided elsewhere on the application, a statement identifying the year in which the item of property was placed in service;

(v) if the item of property is depreciated under former § 168, a statement identifying the asset class in Rev. Proc. 83–35 that applies under the taxpayer's former and new methods of accounting (if none, state and explain);

(vi) if the taxpayer is changing the classification of an item of § 1250 property to a retail motor fuels outlet under § 168(e)(3)(E)(iii), a statement containing the following representation: "For purposes of § 168(e)(3)(E)(iii) of the Internal Revenue Code, the taxpayer represents that (A) 50 percent or more of the gross revenue generated from the item of § 1250 property is from the sale of petroleum products (not including gross revenue from related services, such as the labor cost of oil changes and gross revenue from the sale of nonpetroleum products such as tires and oil filters), (B) 50 percent or more of the floor space in the item of property is devoted to the sale of petroleum products (not including floor space devoted to related services, such as oil changes and floor space devoted to nonpetroleum products such as tires and oil filters), or (C) the item of § 1250 property is 1,400 square feet or less."; and

(vii) if the taxpayer is changing the classification of an item of property from § 1250 property to § 1245 property under § 168 or former § 168, a statement of the facts and law supporting the new § 1245 property classification, and a statement containing the following representation: "Each item of property that is the subject of the application filed under section 2.01 of the APPENDIX of Rev. Proc. 97–37 for the year of change beginning *[Insert the date],* and that is reclassified

from *[Insert, as appropriate: nonresidential real property, residential rental property, 19-year real property, 18- year real property, or 15-year real property] to an asset class of [Insert, as appropriate, either: Rev. Proc. 87–56, 1987–2 C.B. 674, or Rev. Proc. 83–35, 1983–1 C.B. 745]* that does not explicitly include § 1250 property, is § 1245 property for depreciation purposes."

(5) *Section 481(a) adjustment.* The § 481(a) adjustment is a negative § 481(a) adjustment (a decrease in taxable income) to prevent the omission of the allowable but unclaimed depreciation for open and closed years prior to the year of change. This negative § 481(a) adjustment equals the difference between the total amount of depreciation taken into account in computing taxable income for the property under the taxpayer's former method of accounting, and the total amount of depreciation allowable for the property under the taxpayer's new method of accounting (as determined under section 2.01(7) of this APPENDIX), for all taxable years prior to the year of change. The amount of the negative § 481(a) adjustment, however, must be offset by any allowable but unclaimed depreciation that is required to be capitalized under any provision of the Code (for example, § 263A) at the beginning of the year of change.

(6) *Basis adjustment.* The basis of depreciable property to which section 2.01 of this APPENDIX applies must reflect the reductions required by § 1016(a)(2) for the depreciation allowable for the property (as determined under section 2.01(7) of this APPENDIX).

(7) *Meaning of depreciation allowable.*

(a) *In general.* Section 2.01(7) of this APPENDIX provides the amount of the depreciation allowable, determined under § 167, 168, 197, or former § 168. This amount, however, may be limited by other provisions of the Code (for example, § 280F).

(b) *Section 167 property.* Generally, for any taxable year, the depreciation allowable for property for which depreciation is determined under § 167, is determined either:

(i) under the depreciation method adopted by a taxpayer for the property; or

(ii) if that depreciation method does not result in a reasonable allowance for depreciation or a taxpayer has not adopted a depreciation method for the property, under the straight-line depreciation method.

For determining the estimated useful life and salvage value of the property, see §§ 1.167(a)–1(b) and (c), respectively. The depreciation allowable for any taxable year for property subject to § 167(f) (regarding certain property excluded from § 197) is determined by using the depreciation method and useful life prescribed in § 167(f).

(c) *Section 168 property.* The depreciation allowable for any taxable year for property for which depreciation is determined under § 168, is determined by using either:

(i) the general depreciation system in § 168(a); or

(ii) the alternative depreciation system in § 168(g) if the property is required to be depreciated under the alternative depreciation system pursuant to § 168(g)(1) or other provisions of the Code (for example, property described in § 263A(e)(2)(A) or 280F(b)(1)). Property required to be depreciated under the alternative depreciation system pursuant to § 168(g)(1) includes property in a class (as set out in § 168(e)) for which the taxpayer made a timely election under § 168(g)(7).

(d) *Section 197 property.* The depreciation allowable for any taxable year for an amortizable § 197 intangible (including any property for which a timely election under § 13261(g)(2) of the 1993 Act was made) is determined by using the straight-line method over a 15-year period.

(e) *Former § 168 property.* The depreciation allowable for any taxable year for property subject to former § 168 is determined by using either:

(i) the accelerated method of cost recovery applicable to the property (for example, for 5-year property, the recovery method under former § 168(b)(1)); or

(ii) the straight-line method applicable to the property if the property is required to be depreciated under the straight-line method (for example, property described in former § 168(f)(12) or former § 280F(b)(2)) or if the taxpayer elected to determine the depreciation allowance under the optional straight-line percentage (for example, the straight-line method in former § 168(b)(3)).

.02 *Permissible to permissible method of accounting for depreciation.*

(1) *Description of change.* This change applies to a taxpayer that wants to change from a permissible method of accounting for depreciation under § 167 to another permissible method of accounting for depreciation under § 167. Pursuant to §§ 1.167(a)–7(a) and (c), a taxpayer may account for depreciable property either by treating each individual asset as an account or by combining two or more assets in a single account and, for each account, depreciation allowances are computed separately. This change was formerly provided in Rev. Proc. 74–11, 1974–1 C.B. 420.

(2) *Scope.*

(a) *Applicability.* Except as provided in section 2.02(2)(b) of this APPENDIX, this change applies to any taxpayer wanting to make a change in method of accounting for depreciation specified in section 2.02(3) of this APPENDIX for the property in an account:

(i) for which the present and proposed methods of accounting for depreciation specified in section 2.02(3) of this APPENDIX are permissible methods for the property under § 167; and

(ii) that is owned by the taxpayer at the beginning of the year of change.

(b) *Inapplicability.* This change does not apply to:

(i) any taxpayer that is subject to § 263A and that is required to capitalize the costs with respect to which the taxpayer wants to change its method of accounting under section 2.02 of this APPENDIX, if the taxpayer is not capitalizing the costs as required;

(ii) any property to which § 1016(a)(3) (regarding property held by a tax-exempt organization) applies;

(iii) any intangible property;

(iv) any property described in § 167(f) (regarding certain property excluded from § 197);

(v) any property subject to § 167(g) (regarding property depreciated under the income forecast method);

(vi) any property for which depreciation is determined under § 168 or

168 prior to its amendment in 1986 (former § 168);

(vii) any property that the taxpayer elected under § 168(f)(1) or former § 168(e)(2) to exclude from the application of, respectively, § 168 or former § 168;

(viii) any property for which depreciation is determined in accordance with § 1.167(a)–11 (regarding the Class Life Asset Depreciation Range System (ADR)); or

(ix) any depreciable property for which the taxpayer is changing the depreciation method pursuant to § 1.167(e)–1(b) (change from declining-balance method to straight-line method), § 1.167(e)–1(c) (certain changes for § 1245 property), or § 1.167(e)–1(d) (certain changes for § 1250 property). These changes must be made prospectively and are not permitted under the cited regulations for property for which the depreciation is determined under § 168 or former § 168.

(3) *Changes covered.* Section 2.02 of this APPENDIX only applies to the following changes in methods of accounting for depreciation:

(a) a change from the straight-line method to the sum-of-the-years-digits method, the sinking fund method, the unit-of-production method, or the declining-balance method using any proper percentage of the straight-line rate;

(b) a change from the declining-balance method using any percentage of the straight-line rate to the sum-of-the-years-digits method, the sinking fund method, or the declining-balance method using a different proper percentage of the straight-line rate;

(c) a change from the sum-of-the-years-digits method to the sinking fund method, the declining-balance method using any proper percentage of the straight-line rate, or the straight-line method;

(d) a change from the unit-of-production method to the straight-line method;

(e) a change from the sinking fund method to the straight-line method, the unit-of-production method, the sum-of-the-years-digits method, or the declining-balance method using any proper percentage of the straight-line rate;

(f) a change in the interest factor used in connection with a compound interest method or sinking fund method;

(g) a change in averaging convention as set forth in § 1.167(a)–10(b). However, as specifically provided in § 1.167(a)–10(b), in any taxable year in which an averaging convention substantially distorts the depreciation allowance for the taxable year, it may not be used (see Rev. Rul. 73–202, 1973–1 C.B. 81);

(h) a change from charging the depreciation reserve with costs of removal and crediting the depreciation reserve with salvage proceeds to deducting costs of removal as an expense and including salvage proceeds in taxable income as set forth in § 1.167(a)–8(e)(2). *See* Rev. Rul. 74–455, 1974–2 C.B. 63. This change, however, may be made under this revenue procedure only if:

(i) the change is applied to all items in the account for which the change is being made; and

(ii) the removal costs are not required to be capitalized under any provision of the Code (for example, § 263(a), 263A, or 280B);

(i) a change from crediting the depreciation reserve with the salvage proceeds realized on normal retirement sales to computing and recognizing gains and losses on such sales (see Rev. Rul. 70–165, 1970–1 C.B. 43);

(j) a change from crediting ordinary income (including the combination method of crediting the lesser of estimated salvage value or actual salvage proceeds to the depreciation reserve, with any excess of salvage proceeds over estimated salvage value credited to ordinary income) with the salvage proceeds realized on normal retirement sales, to computing and recognizing gains and losses on such sales (see Rev. Rul. 70–166, 1970–1 C.B. 44); or

(k) a change from item accounting for specific assets to multiple asset accounting for the same assets, or vice versa.

(4) *Additional requirements.* A taxpayer also must comply with the following:

(a) *Basis for depreciation.* At the beginning of the year of change, the basis for depreciation of property to which this change applies is the adjusted basis of the property as provided in § 1011 at the end of the taxable year immediately preceding the year of change (determined under the taxpayer's present method of accounting for depreciation). If applicable under the taxpayer's proposed method of accounting for depreciation, this adjusted basis is reduced by the estimated salvage value of the property (for example, a change to the straight-line method).

(b) *Rate of depreciation.* The rate of depreciation for property changed to:

(i) the straight-line or sum-of-the-years-digits method of depreciation must be based on the remaining useful life of the property as of the beginning of the year of change; or

(ii) the declining-balance method of depreciation must be based on the useful life of the property measured from the placed-in-service date, and not the expected remaining life from the date the change becomes effective.

(c) *Regulatory requirements.* For changes in method of depreciation to the sum-of-the-years-digits or declining-balance method, the property must meet the requirements of § 1.167(b)–0 or 1.167(c)–1, as appropriate.

(5) *Section 481(a) adjustment.* Because the adjusted basis of the property is not changed as a result of a method change made under section 2.02 of this APPENDIX, no items are being duplicated or omitted. Accordingly, the § 481(a) adjustment is zero.

.03 *Sale or lease transactions.*

(1) *Description of change and scope.*

(a) *Applicability.* Except as provided in section 2.03(1)(b) of this APPENDIX, this change applies to a taxpayer that wants to change its method of accounting from treating property as sold by the taxpayer to treating property as leased by the taxpayer, and vice versa, and to a taxpayer that wants to change its method of accounting from treating property as purchased by the taxpayer to treating property as leased by the taxpayer, and vice versa.

(b) *Inapplicability.* This change does not apply to:

(i) a rent-to-own dealer that wants to change its method of accounting for rent-to-own contracts described in section 3 of Rev. Proc. 95–38, 1995–2 C.B. 397; or

(ii) a taxpayer that holds assets for sale or lease, if any asset so held is not

the subject of a sale or lease transaction as of the beginning of the year of change.

(2) *Manner of making the change.*

(a) The change in method of accounting under section 2.03 of this APPENDIX is made using a cut-off method and applies to transactions entered into on or after the beginning of the year of change. *See* section 2.06 of this revenue procedure.

(b) If a taxpayer wants to change its method of accounting for existing sale or lease transactions, the taxpayer must file an application with the Commissioner in accordance with the requirements of § 1.446–1T(e)(3)(i) and Rev. Proc. 97–27. A change involving existing sale or lease transactions will require a § 481(a) adjustment. Consent to change a method of accounting for an existing sale or lease transaction is granted only in unusual and compelling circumstances.

(3) *No audit or ruling protection.* A taxpayer does not receive audit protection under section 7 of this revenue procedure in connection with this change. Furthermore, the Commissioner's consent to this change does not constitute acceptance or approval of the taxpayer's characterization of any transaction as a sale or lease.

SECTION 3. CAPITAL EXPENDITURES (§ 263)

.01 *Package design costs.*

(1) *Description of change and scope.* This change applies to a taxpayer that wants to change to one of the three alternative methods of accounting for package design costs described in section 5 of Rev. Proc. 97–35, page 11. The three alternative methods of accounting for package design costs described are: (1) the capitalization method, (2) the design-by-design capitalization and 60-month amortization method, and (3) the pool-of-cost capitalization and 48-month amortization method. This change was formerly provided in Rev. Proc. 90–63, 1990–2 C.B. 664.

(2) *Additional requirements.* If a taxpayer is changing its method of accounting for package design costs to the capitalization method or the design-by-design capitalization and 60-month amortization method, the taxpayer must attach a statement to its timely filed application. The statement must provide a description of each package design, the date on which each was placed in service, and the cost basis of each (as determined under sections 5.01(2) or 5.02(2) of Rev. Proc. 97–35).

.02 *Reserved.*

SECTION 4. UNIFORM CAPITALIZATION (§ 263A)

.01 Certain uniform capitalization (UNICAP) methods used by small resellers, formerly small resellers, and reseller-producers.

(1) *Description of change and scope.*

(a) *Applicability.* This change, which was formerly provided in Rev. Proc. 95–33, 1995–2 C.B. 380, applies to:

(i) a small reseller of personal property changing from a permissible UNICAP method to a permissible non-UNICAP inventory capitalization method in any taxable year that it qualifies as a small reseller;

(ii) a formerly small reseller changing from a permissible non-UNICAP inventory capitalization method to a permissible UNICAP method in the first taxable year that it does not qualify as a small reseller;

(iii) a reseller-producer changing from a permissible UNICAP method for both its production and resale activities to a permissible simplified resale method described in § 1.263A–3(d)(3) in any taxable year that it qualifies to use a simplified resale method for both its production and resale activities under § 1.263A–3(a)(4) (resellers with de minimis production activities); or

(iv) a reseller-producer changing from a permissible simplified resale method described in § 1.263A–3(d)(3) for both its production and resale activities to a permissible UNICAP method for both its production and resale activities in the first taxable year that it does not qualify to use a simplified resale method for both its production and resale activities under § 1.263A–3(a)(4).

(b) *Scope limitations inapplicable*. A taxpayer that wants to make this change is not subject to the scope limitations in section 4.02 of this revenue procedure. However, if the taxpayer is under examination, before an appeals office, or before a federal court, the taxpayer must provide a copy of the application to the examining agent(s), appeals officer, or counsel for the government, as appropriate, at the same time that it files the copy of the application with the national office. The application must contain the name(s) and telephone number(s) of the examining agent(s), appeals officer, or counsel for the government, as appropriate.

(c) *Inapplicability.* This change does not apply to a taxpayer making a historic absorption ratio election under § 1.263A–2(b)(4) or 1.263A–3(d)(4).

(2) *Definitions.*

(a) "Reseller" means a taxpayer that acquires real or personal property described in § 1221(1) for resale.

(b) "Small reseller" means a reseller whose average annual gross receipts for the three immediately preceding taxable years (or fewer, if the taxpayer has not been in existence during the three preceding taxable years) do not exceed $10,000,000. See § 263A(b)(2)(B).

(c) "Formerly small reseller" means a reseller that no longer qualifies as a small reseller.

(d) "Producer" means a taxpayer that produces real or tangible personal property.

(e) "Reseller-producer" means a taxpayer that is both a producer and a reseller.

(f) "Permissible UNICAP method" means a method of capitalizing costs that is permissible under § 263A.

(g) "Permissible non-UNICAP inventory capitalization method" means a method of capitalizing inventory costs that is permissible under § 471.

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

(4) *No audit protection. A taxpayer* does not receive audit protection under section 7 of this revenue procedure in connection with this change.

(5) *Example.* The following example illustrates the principles of section 4.01 of this APPENDIX for small resellers and formerly small resellers.

Assume X, a corporate reseller of per-

sonal property, incorporated January 2, 1991, adopted a taxable year ending December 31. X determines that its average annual gross receipts for the three taxable years (or fewer, if applicable) immediately preceding taxable years 1991 through 2000 are as shown in the table below:

Current Taxable Year	*AVERAGE Annual Gross Receipts for the Three Taxable Years Immediately Preceding the Current Taxable Year*
1991	$ 0
1992	5,000,000
1993	6,000,000
1994	7,000,000
1995	11,000,000
1996	11,000,000
1997	9,000,000
1998	8,000,000
1999	11,000,000
2000	12,000,000

Furthermore, X, which adopted the dollar-value LIFO inventory method, has the following LIFO inventory balances determined without considering the effects of the UNICAP method:

	Beginning	Ending
1995	$1,000,000	$1,100,000
1996	1,100,000	1,200,000
1997	1,200,000	1,300,000
1998	1,300,000	1,400,000
1999	1,400,000	1,500,000
2000	1,500,000	1,600,000

X was required by § 263A to change to the UNICAP method for 1995 because its average annual gross receipts for the three taxable years immediately preceding 1995 were $11,000,000, which exceeded the $10,000,000 ceiling permitted by the small reseller exception. Assume that X was required to capitalize $80,000 of "additional § 263A costs" to the cost of its 1995 beginning inventory because of this change in inventory method. In addition, X was required to include one-fourth of the § 481(a) adjustment when computing taxable income for each of the four taxable years beginning with 1995. Thus, X was required to include a $20,000 positive § 481(a) adjustment in its 1995 taxable income.

X elected to use the simplified resale method without a historic absorption ratio election under § 1.263A–3(d)(3) for determining the amount of additional § 263A costs to be capitalized to each LIFO layer. Assume that X was required to add $10,000 of additional § 263A costs to the cost of its 1995 ending inventory because of the $100,000 increment for 1995.

X's 1995 Ending Inventory:

Beginning Inventory (Without UNICAP costs)	$1,000,000
1995 Increment	100,000
Additional § 263A Costs in Beginning Inventory	80,000
Additional § 263A Costs in 1995 Increment	10,000
Total 1995 Ending Inventory	$1,190,000

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

1995 § 481(a) Adjustment	$80,000
Amount Included in 1995 Taxable Income	<20,000>
Unamortized 1995 § 481(a) Adjustment—12/31/95	$60,000

Because X failed to satisfy the small reseller exception for 1996, X was required to continue using the UNICAP method for its inventory costs. Furthermore, X was required to include $20,000 of the unamortized 1995 positive § 481(a) adjustment in 1996 taxable income. Assume that X was required to add $10,000 of additional § 263A costs to the cost of its 1996 ending inventory because of the $100,000 increment for 1996.

X's 1996 Ending Inventory:

Beginning Inventory (With UNICAP costs)	$1,190,000
1996 Increment	100,000
Additional § 263A Costs in 1996 Increment	10,000
Total 1996 Ending Inventory	$1,300,000

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

Unamortized 1995 § 481(a) Adjustment—12/31/95	$60,000
Amount Included in 1996 Taxable Income	<20,000>
Unamortized 1995 § 481(a) Adjustment—12/31/96	$40,000

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). Because X used the UNICAP method for only two years (that is, 1995 and 1996), X must include one-half of the § 481(a) adjustment when computing taxable income for each of the two taxable years beginning with 1997. Thus, X must include a $50,000 negative § 481(a) adjustment in 1997 taxable income. 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	50,000
Unamortized 1997 § 481(a) Adjustment—12/31/97	$< 50,000>

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 and $50,000 of the unamortized 1997 negative § 481(a) adjustment in 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

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

Unamortized 1997 § 481(a) Adjustment—12/31/97	$<50,000>
Amount Included in 1998 Taxable Income	50,000
Unamortized 1997 § 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. In addition, X must determine the appropriate adjustment period for the corresponding positive § 481(a) adjustment. Because X used its former inventory method for two taxable years before 1999 (that is, 1997 and 1998), X must include one-half of the § 481(a) adjustment when computing taxable income for each of the two taxable years beginning with 1999. Thus, X must include a $60,000 positive § 481(a) adjustment in its 1999 taxable income. 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

.02 *Reserved.*

SECTION 5. METHODS OF ACCOUNTING (§ 446)

.01 *Cash or hybrid method to accrual method.*

(1) *Description of change and scope.*

(a) *Applicability.* Except as provided in section 5.01(1)(b) of this APPENDIX, this change, which was formerly provided, in part, in Rev. Proc. 92–75, 1992–2 C.B. 448, and Rev. Proc. 92–74, 1992–2 C.B. 442, applies to:

(i) a taxpayer that wants to change to an overall accrual method, or to an overall accrual method in conjunction with the recurring item exception under § 461(h)(3), from the cash receipts and disbursements method (cash method), or from a hybrid method (under which certain items of income or expense are reported on the cash method and other items of income or expense are reported on an accrual method or other methods); or

(ii) a taxpayer that is required to change to an overall accrual method under § 448, but is ineligible to make the change under § 1.448–1(h)(2) (relating to the "first § 448 year").

(b) *Inapplicability.* This change does not apply to:

(i) a financial institution described in § 581 or 591;

(ii) a farmer;

(iii) a cooperative organization described in § 501(c)(12), 521, or 1381;

(iv) an individual taxpayer, except for activities conducted as a sole proprietorship;

(v) a taxpayer required to use an inventory method of accounting, unless:

(A) the taxpayer adopts a proper inventory method under § 471 and the regulations thereunder, the taxpayer is a small reseller within the meaning of § 1.263A–3(a), and, if the taxpayer has production activities, the taxpayer's production activities qualify under the de minimis presumption of § 1.263A–3(a)-(2)(iii); or

(B) the taxpayer adopts a proper inventory method under § 471 and the regulations thereunder, the taxpayer is a reseller eligible to use the simplified resale method under § 1.263A–3(d), and the taxpayer adopts a proper method under that section for the year of change;

(vi) a taxpayer required to use a long-term contract method in accordance with § 460, if the taxpayer is not in compliance with that section and any related administrative guidance;

(vii) a taxpayer required or wanting to use a special method of accounting, unless the taxpayer is permitted to change automatically to the special method under this revenue procedure. A special method of accounting is a method that deviates from the normal tax accounting rules, such as the method of accounting for advance payments pursuant to either Rev. Proc. 71–21, 1971–2 C.B. 549, or § 1.451–5, the installment method of accounting under § 453, or a long-term contract method under § 460; or

(viii) a taxpayer required to change to an overall accrual method under § 448 and eligible to make the change under § 1.448–1(h)(2). *See* § 1.448–1(h)-(2), which provides an automatic consent procedure for a taxpayer changing for the first taxable year that it is subject to § 448. *See also* § 1.448–1(h)(1), which provides that § 1.448–1(h) does not apply to a change required under any Code section (or regulations thereunder) other than § 448 (for example, a taxpayer with inventories).

(2) *Section 481(a) adjustment.*

(a) *In general.* The § 481(a) adjustment takes into account the accounts receivable, accounts payable, inventory, and any other item determined to be necessary in order to prevent items from being duplicated or omitted. The § 481(a) adjustment does not include any item of income accrued but not received that was worthless or partially worthless (within the meaning of § 166(a)) on the last day of the year preceding the year of change.

(b) *Recurring item exception.* As part of the change to an overall accrual

method, a taxpayer may adopt the recurring item exception for the year of change if the taxpayer is eligible and follows the procedures of § 1.461–5(d). If the taxpayer is eligible and wants to adopt this method as specified in § 461(h)(3), the amount of the § 481(a) adjustment must be modified to account for the amount of any additional deduction.

(3) *Change to a special method of accounting.* If a taxpayer that wants to change to an accrual method in conjunction with a change to a special method of accounting is not permitted to make the change under this revenue procedure, the taxpayer may request to make both changes only by filing one application under the provisions of Rev. Proc. 97–27, 1997–21 I.R.B. 10. Only one user fee will be required for these changes.

.02 *Multi-year service warranty contracts.*

(1) *Description of change and scope.*

(a) *Applicability.* This change applies to an eligible accrual method manufacturer, wholesaler, or retailer of motor vehicles or other durable consumer goods that wants to change to the service warranty income method described in section 5 of Rev. Proc. 97–38, page 43. Under the service warranty income method, a qualifying taxpayer may, in certain specified and limited circumstances, include a portion of an advance payment related to the sale of a multi-year service warranty contract in gross income generally over the life of the service warranty obligation. This change was formerly provided in Rev. Proc. 92–98, 1992–2 C.B. 512.

(b) *Inapplicability.* This change does not apply to a taxpayer outside the scope of Rev. Proc. 97–38.

(2) *Manner of making the change.*

(a) This change is made using a cut-off method, under which the taxpayer begins the use of the service warranty income method for all qualified advance payment amounts received in the year of change and thereafter. *See* section 2.06 of this revenue procedure.

(b) In accordance with § 1.446–1-(e)(3)(ii), the requirement of § 1.446–1(e)-(3)(i) to file an application on Form 3115 is waived and a statement in lieu of the Form 3115 is authorized for this change. The statement must be identified at the top as follows: "CHANGE TO THE SERVICE WARRANTY INCOME METHOD UNDER SECTION 5.02 OF THE APPENDIX OF REV. PROC. 97–37." The statement must set forth the information required under section 6.03 of Rev. Proc. 97–38, except that the statement under section 6.03(2) (that the taxpayer agrees to all of the terms and conditions of the revenue procedure) also should refer to Rev. Proc. 97–37.

(c) A taxpayer changing to the service warranty income method of accounting under section 5.02 of this APPENDIX must satisfy the annual reporting requirement set forth in section 6.04 of Rev. Proc. 97–38.

.03 *Multi-year insurance policies for multi-year service warranty contracts — Description of change and scope.*

(1) *Applicability.* Except as provided in section 5.03(2) of this APPENDIX, this change applies to a manufacturer, wholesaler, or retailer of motor vehicles or other durable consumer goods that wants to change its method of accounting for insurance costs paid or incurred to insure its risks under multi-year service warranty contracts to the method described in section 5.03(3) of this APPENDIX. Multi-year service warranty contracts to which this change applies include only those separately priced contracts sold by a manufacturer, wholesaler, or retailer also selling the motor vehicles or other durable consumer goods (to the ultimate customer or to an intermediary) underlying the contracts. The classification of goods as "durable consumer goods" for purposes of this change depends on the common usage of the goods, rather than the purchaser's actual intended use of the goods. This change was formerly provided in Rev. Proc. 92–97, 1992–2 C.B. 510.

(2) *Inapplicability.* This change does not apply to a taxpayer that covers its risks under its multi-year service warranty contracts through arrangements not constituting insurance.

(3) *Description of method.* If a taxpayer purchases a multi-year service warranty insurance policy (in connection with its sale of multi-year service warranty contracts to customers) by paying a lump-sum premium in advance, the taxpayer must capitalize the amount paid or incurred and may only obtain deductions for that amount by prorating (or amortizing) it over the life of the insurance policy (whether the cash method or an accrual method of accounting is used to account for service warranty transactions).

SECTION 6. OBLIGATIONS ISSUED AT DISCOUNT (§ 454)

.01 *Series E or EE U.S. savings bonds.*

(1) *Description of change and scope.* This change applies to a cash method taxpayer that wants to change its method of accounting for interest income on Series E or EE U.S. savings bonds. However, this change only applies to a taxpayer that has previously made an election under § 454 to report as interest income the increase in redemption price on a bond occurring in a taxable year, and that now wants to report this income in the taxable year in which the bond is redeemed, disposed of, or finally matures, whichever is earliest. This change was formerly provided in Rev. Proc. 89–46, 1989–2 C.B. 597.

(2) *Manner of making the change.*

(a) This change is made using a cut-off method and is effective for any increase in redemption price occurring after the beginning of the year of change for all Series E and EE U.S. savings bonds held by the taxpayer on or after the beginning of the year of change. *See* section 2.06 of this revenue procedure.

(b) In accordance with § 1.446–1-(e)(3)(ii), the requirement of § 1.446–1(e)-(3)(i) to file an application on Form 3115 is waived and a statement in lieu of the Form 3115 is authorized for this change. The statement must be identified at the top as follows: "CHANGE IN METHOD OF ACCOUNTING UNDER SECTION 6.01 OF THE APPENDIX OF REV. PROC. 97–37." The statement must set forth:

(i) the Series E or EE U.S. savings bonds for which this change in accounting method is requested;

(ii) an agreement to report all interest on any bonds acquired during or after the year of change when the interest is realized upon disposition, redemption, or final maturity, whichever is earliest; and

(iii) an agreement to report all interest on the bonds acquired before the year of change when the interest is realized upon disposition, redemption, or final maturity, whichever is earliest, with the exception of any interest income pre-

viously reported in prior taxable years.

.02 *Reserved.*

SECTION 7. PREPAID SUBSCRIPTION INCOME (§ 455)

.01 *Prepaid subscription income.*

(1) *Description of change and scope.* This change applies to an accrual method taxpayer that wants to change its method of accounting for prepaid subscription income to the method described in § 455 and the regulations thereunder, including an eligible taxpayer that wants to make the "within 12 months" election under § 1.455–2. This change was formerly provided, in part, in Rev. Proc. 84–76, 1984–2 C.B. 751.

(2) *Manner of making the change.*

(a) This change is made using a cut-off method and does not apply to any prepaid subscription income received before the first taxable year to which the change applies. Any prepaid subscription income arising prior to the year of change is accounted for under the taxpayer's former method of accounting. See section 2.06 of this revenue procedure.

(b) In accordance with § 1.446–1-(e)(3)(ii), the requirement of § 1.446–1(e)-(3)(i) to file an application on Form 3115 is waived and a statement in lieu of the Form 3115 is authorized for this change. The statement must be identified at the top as follows: "CHANGE IN METHOD OF ACCOUNTING FOR PREPAID SUBSCRIPTION INCOME UNDER SECTION 7.01 OF THE APPENDIX OF REV. PROC. 97–37." The statement must set forth the information required under § 1.455–6(b).

.02 *Reserved.*

SECTION 8. TAXABLE YEAR OF DEDUCTION (§ 461)

.01 *Timing of incurring liabilities for employee compensation.*

(1) *Description of change and scope.*

(a) *Applicability.* This change applies to an accrual method taxpayer that wants to change its method of accounting to treat bonuses or self-insured medical benefits as follows:

(i) *Bonuses.* If the obligation to pay a bonus becomes fixed and certain by the end of the taxable year (see Rev. Rul. 61–27, 1961–2 C.B. 36), and the bonus is otherwise deductible, but the bonus is paid after the 15th day of the third calendar month after the end of that taxable year, to treat the bonus as deductible in the taxable year of the employer in which or with which ends the taxable year of the employee in which the bonus is includible in the gross income of the employee; or

(ii) *Self-insured medical benefits.* If the obligation to pay an employee's medical expenses is neither insured nor paid from a welfare benefit fund within the meaning of § 419(e), to treat the liability as incurred in the taxable year in which the employee files the claim with the employer. *See United States v. General Dynamics Corp.*, 481 U.S. 239 (1987), 1987–2 C.B. 134.

(b) *Inapplicability.* This change does not apply to a taxpayer that is subject to § 263A and that is required to capitalize the costs with respect to which the taxpayer wants to change its method of accounting under section 8.01 of this APPENDIX, if the taxpayer is not capitalizing the costs as required.

(2) *Amounts taken into account.* Applicable provisions of the Code, regulations, and other published guidance prescribe the manner in which a liability that has been incurred is taken into account. For example, for a taxpayer with inventories, direct labor costs must be included in inventory costs and may be recovered through cost of goods sold. *See* § 1.263A–1(e)(2)(i)(B). A taxpayer may not rely on the provisions of section 8.01 of this APPENDIX to take a current year deduction.

.02 *Timing of incurring liabilities for real property taxes.*

(1) *Description of change.* An accrual method taxpayer generally incurs a liability in the taxable year that all the events have occurred that establish the fact of the liability, the amount of the liability can be determined with reasonable accuracy, and economic performance has occurred with respect to the liability. See § 1.446–1(c)(1)(ii). Under § 1.461–4-(g)(6), if the liability of the taxpayer is to pay a tax, economic performance occurs as the tax is paid to the government authority that imposed the tax.

(2) *Scope.*

(a) *Applicability.* This change applies to an accrual method taxpayer that wants to change its method of accounting to:

(i) treat a liability for real property taxes as incurred in the taxable year in which the taxes are paid, under §§ 461 and 1.461–4(g)(6);

(ii) account for real property taxes under the recurring item exception to the economic performance rules under §§ 461(h)(3) and 1.461–5(b)(1); or

(iii) revoke an election under § 461(c) (ratable accrual election).

(b) *Inapplicability.* This change does not apply to a taxpayer that is subject to § 263A and that is required to capitalize the costs with respect to which the taxpayer wants to change its method of accounting under section 8.02 of this APPENDIX, if the taxpayer is not capitalizing the costs as required.

(3) *Amounts taken into account.* Applicable provisions of the Code, regulations, and other published guidance prescribe the manner in which a liability that has been incurred is taken into account. For example, for a taxpayer with inventories, certain real property taxes must be included in inventory costs and may be recovered through cost of goods sold. *See* § 1.263A–1(e)(3)(ii)(L). A taxpayer may not rely on the provisions of section 8.02 of this APPENDIX to take a current year deduction.

.03 *Timing of incurring liabilities under a workers' compensation act, tort, breach of contract, or violation of law.*

(1) *Description of change and scope.*

(a) *Applicability.* This change applies to an accrual method taxpayer that wants to change its method of accounting for self-insured liabilities (including any amounts not covered by insurance, such as a "deductible" amount under an insurance policy) arising under any workers' compensation act or out of any tort, breach of contract, or violation of law, to treating the liability for the workers' compensation, tort, breach of contract, or violation of law as being incurred in the taxable year in which all the events have occurred which establish the fact of the liability, the amount of the liability can be determined with reasonable accuracy, and payment is made to the person to which the liability is owed. *See* § 461 and § 1.461–4(g)(2).

(b) *Inapplicability.* This change does not apply:

(i) to a taxpayer that is subject

to § 263A and that is required to capitalize the costs with respect to which the taxpayer wants to change its method of accounting under section 8.03 of this APPENDIX, if the taxpayer is not capitalizing the costs as required;

(ii) if payment is made to a third party rather than to the person to which the liability is owed. See § 1.461–4(g)(1); or

(iii) if payment is made by a third party.

(2) *Amounts taken into account.* Applicable provisions of the Code, regulations, and other published guidance prescribe the manner in which a liability that has been incurred is taken into account. For example, for a taxpayer with inventories, certain employee benefit costs (including workers' compensation) must be included in inventory costs and may be recovered through costs of goods sold. *See* § 1.263A–1(e)(3)(ii)(D). A taxpayer may not rely on the provisions of section 8.03 of this APPENDIX to take a current year deduction.

.04 *Timing of incurring liabilities for payroll taxes.*

(1) *Description of change and scope.*

(a) *Applicability.* This change applies to an accrual method employer that wants to change its method of accounting for FICA and FUTA taxes to a method consistent with the holding in Rev. Rul. 96–51, 1996–43 I.R.B. 5. Rev. Rul. 96–51 holds that, under the all events test of § 461, an accrual method employer may deduct in Year 1 its otherwise deductible FICA and FUTA taxes imposed with respect to year-end wages properly accrued in Year 1, but paid in Year 2, if the requirements of the recurring item exception are met.

(b) *Inapplicability.* This change does not apply to a taxpayer that is subject to § 263A and that is required to capitalize the costs with respect to which the taxpayer wants to change its method of accounting under section 8.04 of this APPENDIX, if the taxpayer is not capitalizing the costs as required.

(2) *Recurring item exception.* As part of this change, a taxpayer that previously has not changed to or adopted the recurring item exception for FICA and FUTA taxes must change to the recurring item exception method for FICA and FUTA taxes as specified in § 461(h)(3).

(3) *Amounts taken into account.* Applicable provisions of the Code, regulations, and other published guidance prescribe the manner in which a liability that has been incurred is taken into account. For example, for a taxpayer with inventories, certain taxes must be included in inventory costs and may be recovered through cost of goods sold. See § 1.263A–1(e)(3)(ii)(L). A taxpayer may not rely on the provisions of section 8.04 of this APPENDIX to take a current year deduction.

SECTION 9. INVENTORIES (§ 471)

.01 *Cash discounts — Description of change and scope.* This change applies to a taxpayer that wants to change its method of accounting for cash discounts (discounts granted for timely payment) when they approximate a fair interest rate, from a method of consistently including the price of the goods before discount in the cost of the goods and including in gross income any discounts taken (the "gross invoice method"), to a method of reducing the cost of the goods by the cash discounts and deducting as an expense any discounts not taken (the "net invoice method"), or vice versa. See Rev. Rul. 73–65, 1973–1 C.B. 216.

.02 *Reserved.*

SECTION 10. LAST-IN, FIRST-OUT (LIFO) INVENTORIES (§ 472)

.01 *Change from the LIFO inventory method.*

(1) *Description of change and scope.*

(a) *In general.* This change, which was formerly provided in Rev. Proc. 88–15, 1988–1 C.B. 683, applies to any taxpayer that wants to:

(i) change from the LIFO inventory method for all its LIFO inventory; and

(ii) change to the permitted method as determined in section 10.01(1)(b) of this APPENDIX.

(b) *Method to be used.*

(i) *Determining method to be used.* The inventory method to be used by a taxpayer is determined as follows:

(A) If the taxpayer has inventoriable goods not included in its LIFO inventory computations (non-LIFO inventory) and, for all the taxpayer's non-LIFO inventory, the taxpayer uses an inventory method that is a permitted method, then the taxpayer must use that same inventory method for its entire inventory.

(B) If the LIFO inventory method is used by the taxpayer with respect to all its inventoriable goods, then the taxpayer must use the same inventory method it used prior to the adoption of the LIFO inventory method, if that prior method is a permitted method.

(C) If the taxpayer has only LIFO inventory and the method used by the taxpayer prior to the adoption of the LIFO inventory method is not a permitted method, then the taxpayer must use a permitted method.

(D) If the taxpayer did not use an inventory method prior to the adoption of the LIFO inventory method and has no inventoriable goods other than its LIFO inventory, then the taxpayer must use a permitted method.

(ii) *Permitted method defined.* For purposes of section 10.01 of this APPENDIX, a permitted method is a method under which:

(A) the identification method is either the first-in, first-out (FIFO) inventory method or the specific identification inventory method; and

(B) the valuation method is cost; cost or market, whichever is lower; market (but only if the taxpayer is a dealer in securities, as defined in § 1.471–5); the "farm price method" or the "unit-livestock-price method" (but only if the taxpayer is a farmer permitted to use such methods); or the retail method, reduced to either approximate cost or approximate cost or market, whichever is lower (but only if the taxpayer is a retail merchant).

(iii) *Method not to be used.* The average cost method (sometimes also referred to as "the rolling average method") described in Rev. Rul. 71–234, 1971–1 C.B. 148, is not a permitted method.

(iv) *Determining permitted method.* Whether an inventory method is a permitted method is determined by the taxpayer's method of inventory identification and valuation, and not by which types and amounts of costs are capitalized under the taxpayer's method of computing inventory cost. *See* § 263A and the regulations thereunder, which govern the types and amounts of costs required to be included in inventory cost for taxpayers subject to those provisions.

(2) *Limitation on LIFO election.* The taxpayer may not re-elect the LIFO inventory method for a period of at least five taxable years beginning with the year of change, unless based on a showing of unusual and compelling circumstances, consent is specifically granted by the Commissioner to change the method of accounting at an earlier time. The request for consent to readopt the LIFO inventory method must comply with Rev. Proc. 97–27.

(3) *Effect of subchapter S election by corporation.*

(a) *S election effective for year of LIFO discontinuance.* If a C corporation elects to be treated as an S corporation for the taxable year in which it discontinues use of the LIFO inventory method, § 1363(d) requires an increase in the taxpayer's gross income for the LIFO recapture amount (as defined in § 1363(d)(3)) for the taxable year preceding the year of change (the taxpayer's last taxable year as a C corporation), and a corresponding adjustment to the basis of the taxpayer's inventory as of the end of the taxable year preceding the year of change. Any increase in income tax as a result of the inclusion of the LIFO recapture amount is payable in four equal installments, beginning with the taxpayer's last taxable year as a C corporation as provided in § 1363(d)(2). Any corresponding basis adjustment is taken into account in computing the § 481(a) adjustment (if any) that results upon the discontinuance of the LIFO method by the corporation.

(b) *S election effective for a year after LIFO discontinuance.* If a C corporation elects to be treated as an S corporation for a taxable year after the taxable year in which it discontinued use of the LIFO inventory method, the remaining balance of any positive § 481(a) adjustment must be included in its gross income in its last taxable year as a C corporation. If this inclusion results in an increase in tax for its last taxable year as a C corporation, this increase in tax is payable in four equal installments, beginning with the taxpayer's last taxable year as a C corporation as provided in § 1363(d)(2), unless the taxpayer is required to take the remaining balance of the § 481(a) adjustment into account in the last taxable year as a C corporation under another acceleration provision in section 5.02(3)(c) of this revenue procedure.

(4) *Additional requirements.* The taxpayer must complete the following statements and attach them to the application:

(a) "The new method of identifying inventory goods is the [insert method; that is, specific identification; FIFO; retail; etc.] method."

(b) "The new method of valuing inventory goods is [insert method; that is, cost; cost or market, whichever is lower; etc.]."

(c) "The new method conforms to the requirements of section 10.01(1)(b)(i) [insert either (A), (B), (C), or (D)] of the APPENDIX of Rev. Proc. 97–37 because [explain in detail how the new method conforms to the specific subdivision]."

.02 *Determining the cost of used vehicles purchased or taken as a trade-in.*

(1) *Description of change and scope.* This change applies to a LIFO taxpayer that wants to:

(a) determine the cost of used vehicles acquired by trade-in using the average wholesale price listed by an official used car guide on the date of the trade-in. *See* Rev. Rul. 67–107, 1967–1 C.B. 115. The official used car guide selected must be consistently used;

(b) determine the cost of used vehicles purchased for cash using the actual purchase price of the vehicle; or

(c) reconstruct the beginning-of-the-year cost of used vehicles purchased for cash using values computed by national auto auction companies based on vehicles purchased for cash. The national auto auction company selected must be consistently used.

(2) *Manner of making the change.* This change is made using a cut-off method and applies to used vehicles acquired during the year of change and all subsequent years. See section 2.06 of this revenue procedure.

.03 *Alternative LIFO inventory method for retail automobile dealers.*

(1) *Description of change and scope.*

(a) *Applicability.* This change, which was formerly provided in Rev. Proc. 92–79, 1992–2 C.B. 457, applies to a taxpayer engaged in the trade or business of retail sales of new automobiles or new light-duty trucks ("automobile dealer") that wants to change to the "Alternative LIFO Method" described in section 4 of Rev. Proc. 97–36, page 14, for its LIFO inventories of new automobiles and new light-duty trucks. Light-duty trucks are trucks with a gross vehicle weight of 14,000 pounds or less, which also are referred to as class 1, 2, or 3 trucks.

(b) *Inapplicability.* This change does not apply to an automobile dealer that uses the inventory price index computation (IPIC) method for goods other than new automobiles, new light-duty trucks, parts and accessories, used automobiles, and used trucks.

(2) *Manner of making the change.*

(a) *Cut-off method.* This change is made using a cut-off method. See section 2.06 of this revenue procedure and section 5.03(6) of Rev. Proc. 97–36.

(b) *IPIC method changes.* An automobile dealer that uses the IPIC method also must change from the IPIC method under section 10.03 of this APPENDIX to another acceptable method for its goods other than new automobiles and new light-duty trucks. For parts and accessories, the automobile dealer must change to the dollar-value, index method, with all parts and accessories within each separate trade or business in a separate LIFO pool. For used vehicles, the automobile dealer must change to the dollar-value, link-chain method, with all used automobiles within each separate trade or business in one LIFO pool and all used trucks within each separate trade or business in another separate LIFO pool.

(c) *Additional requirements.* An automobile dealer also must comply with the following:

(i) the conditions in section 5.03 of Rev. Proc. 97–36; and

(ii) for an automobile dealer changing from the IPIC method, the automobile dealer also must attach to the application a schedule setting forth the classes of goods for which the automobile dealer has elected to use the LIFO method and the accounting method changes being made under section 10.03 of this APPENDIX for each class of goods.

.04 *Inventory price index computation (IPIC) method under the LIFO inventory method.*

(1) *Description of change and scope.*

(a) This change applies to an eligible taxpayer that wants to change its

LIFO inventory method to use the IPIC method for its entire LIFO inventory in accordance with all the provisions of § 1.472–8(e)(3) and Rev. Proc. 84–57, 1984–2 C. B. 496. The taxpayer must:

(i) in the case of the CPI Detailed Report, select an index from Table 3 (Consumer Price Index for All Urban Consumers (CPI–U): U.S. city average, detailed expenditure categories); and

(ii) in the case of the Producer Price Indexes, select an index from Table 6 (Producer price indexes and percent changes for commodity groupings and individual items).

(b) A taxpayer using the IPIC method must apply the inventory price index to its ending inventory valued at current-year cost, under the taxpayer's method of determining current-year cost. *See* § 1.472–8(e)(2)(ii). Furthermore, there must be a nexus between the taxpayer's method of determining current-year costs and the month to be used in selecting indexes. *See* § 1.472–8(e)(3)(iii)(C) and Rev. Rul. 89–29, 1989–1 C.B. 168. For example, if a taxpayer determines current-year cost by reference to the actual cost of goods purchased or produced during the taxable year in the order of acquisition (earliest acquisitions cost), then the inventory price index must be applied to the earliest acquisitions cost of ending inventory. In computing the inventory price index, such a taxpayer must select indexes from a month toward the beginning of its taxable year.

(c) A taxpayer may not change its method of pooling as part of a change made under section 10.04 of this APPENDIX, except to a method specifically authorized by § 1.472–8(e)(3)(iv) or section 3.04(1)(b) of Rev. Proc. 84–57. These special pooling rules do not apply to goods manufactured by the taxpayer. *See* § 1.472–8(b) for principles for establishing pools of manufacturers and processors.

(d) A taxpayer may change its method of determining current-year cost as part of a change made under section 10.04 of this APPENDIX by also following the provisions of section 10.05 of this APPENDIX. These changes may be made using a single application, provided the application is labeled as being filed under both sections 10.04 and 10.05 of this APPENDIX. *See* section 6.02(3) of this revenue procedure.

(2) *Manner of making the change.* This change is made using a cut-off method. See section 2.06 of this revenue procedure.

.05 *Determining current-year cost under the LIFO inventory method.*

(1) *Description of change and scope.* This change applies to a LIFO taxpayer that wants to change to a method of determining current year cost:

(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; or

(c) by application of an average unit cost equal to the aggregate actual cost of all the goods purchased or produced throughout the taxable year divided by the total number of units so purchased or produced. *See* § 1.472–8(e)(2)(ii).

(2) *Manner of making the change.* This change is made using a cut-off method. *See* section 2.06 of this revenue procedure.

SECTION 11. BANK RESERVES FOR BAD DEBTS (§ 585)

.01 *Changing from the § 585 reserve method to the § 166 specific charge-off method.*

(1) *Description of change and scope.*

(a) *Applicability.* Except as provided in section 11.01(1)(b) of this APPENDIX, this change applies to a bank (as defined in § 581, including a bank for which a qualified subchapter S subsidiary (QSSS) election is filed) that wants to change its method of accounting for bad debts from the § 585 reserve method to the § 166 specific charge-off method.

(b) *Inapplicability.* This change does not apply to:

(i) a large bank as defined in § 585(c)(2); or

(ii) any bank within the scope of Rev. Proc. 97–18, 1997–10 I.R.B. 53, which applies to banks making this change in method of accounting in 1997 to become eligible to elect S corporation status for 1997. A bank is not outside the scope of Rev. Proc. 97–18 solely because it is a qualified subchapter S subsidiary. In that event, the S corporation (the parent) should follow the application procedures required by Rev. Proc. 97–18 on behalf of the bank.

(2) *Certain scope limitations inapplicable.* A bank that changed from the § 593 reserve method under § 593(g) to the § 585 reserve method will not be prohibited under section 4.02(6) of this revenue procedure from changing its method of accounting for bad debts under section 11.01 of this APPENDIX solely because of the § 593(g) change. A bank for which a QSSS election is filed will not be prohibited under section 4.02(7) of this revenue procedure from changing its method of accounting for bad debts under section 11.01 of this APPENDIX solely because of the deemed liquidation of the bank arising from a QSSS election.

(3) *Section 481(a) adjustment.* Generally, the amount of the § 481(a) adjustment for a change in method of accounting under section 11.01 of this APPENDIX is the amount of the bank's reserve for bad debts as of the close of the taxable year immediately before the year of change. However, the amount of the § 481(a) adjustment does not include the amount of a bank's pre–1988 reserves (as described in § 593(g)(2)(A)(ii), without taking into account § 593(g)(2)(B)) if the bank changed in a prior year from the § 593 reserve method to the § 585 reserve method and § 593(g) applied to that change. The deemed liquidation of a bank occurring solely because its parent makes a QSSS election does not accelerate the § 481(a) adjustment. In accordance with section 5.04(3)(c) of this revenue procedure, a bank that ceases to be a bank under § 581 must accelerate its § 481(a) adjustment.

(4) *Change from § 585 required when electing S corporation status.* A bank electing S corporation status (or a bank for which a QSSS election is filed) cannot use the § 585 reserve method. The filing by a bank of a Form 2553 (Election by a Small Business Corporation) or the filing by a bank's parent of a QSSS election with respect to the bank will constitute an agreement by the bank to change its method of accounting for bad debts from the § 585 reserve method to the § 166 specific charge-off method effective as of the taxable year for which the S corporation election or QSSS election is effective (year of change) in accordance with all of the applicable provisions of

this revenue procedure. The § 481(a) adjustment is recognized built-in gain under § 1374. *See* § 1.1374–4(d).

.02 *Reserved.*

SECTION 12. ORIGINAL ISSUE DISCOUNT (§ 1273)

.01 *De minimis original issue discount (OID).*

(1) *Description of change and scope.*

(a) *Applicability.* This change, which was formerly provided in Rev. Proc. 94–29, 1994–1 C.B. 616, applies to a taxpayer that wants to change to the principal-reduction method of accounting described in section 5 of Rev. Proc. 97–39, page 48. The principal-reduction method of accounting is an aggregate method of accounting for de minimis OID (discount) on certain loans originated by the taxpayer.

(b) *Scope limitations inapplicable.* A taxpayer that wants to make this change is not subject to the scope limitations in section 4.02 of this revenue procedure. However, if the taxpayer is under examination, before an appeals office, or before a federal court, the taxpayer must provide a copy of the application to the examining agent(s), appeals officer, or counsel for the government, as appropriate, at the same time that it files the copy of the application with the national office. The application must contain the name(s) and telephone number(s) of the examining agent(s), appeals officer, or counsel for the government, as appropriate.

(c) *Description.* The principal-reduction method of accounting is a permissible method for use by taxpayers to account for discount on one or more categories of loans described in section 4.02 or 4.03 of Rev. Proc. 97–39. If the principal-reduction method is used to account for any loans in a category of loans, the method must be used for the entire category of loans. The principal-reduction method applies only to loans described in section 3 of Rev. Proc. 97–39.

(2) *Manner of making the change.*

(a) This change is made using a cut-off method and applies only to loans described in section 3 of Rev. Proc. 97–39 that were acquired on or after the first day of the year of change. *See* section 2.06 of this revenue procedure.

(b) The taxpayer must maintain books and records sufficient to satisfy the district director that old and new loans have been adequately segregated.

(3) *Additional requirements.* On a statement attached to the application, the taxpayer must:

(a) identify the categories of loans to which the new method will apply; and

(b) describe any "additional categories" permitted under section 4.03 of Rev. Proc. 97–39.

(4) *No audit protection.* A taxpayer does not receive audit protection under section 7 of this revenue procedure in connection with this change.

.02 *Reserved.*

SECTION 13. SHORT-TERM OBLIGATIONS (§ 1281)

.01 *Interest income on short-term obligations.*

(1) *Description of change and scope.*

(a) This change applies to a taxpayer that wants to change its method of accounting to comply with § 1281 for interest income on short-term obligations. This change was formerly provided in Rev. Proc. 90–37, 1990–2 C.B. 361.

(b) Under § 1281, a holder of certain short-term obligations, including a bank as defined in § 581, must include in gross income any accrued interest income on such obligations, regardless of the holder's overall method of accounting. Section 1281 applies to all types of interest income, including acquisition discount, original issue discount (OID), and stated interest. *See* S. Rep. No. 99–313, 99th Cong., 2d Sess. 903 (1986), 1986–3 (Vol. 3) C.B. 903.

(c) Section 1283(a)(1) generally defines a short-term obligation as any bond, debenture, note, certificate, or other evidence of indebtedness that matures in one year or less from its issue date. A short-term loan, including a short-term loan made in the ordinary course of the taxpayer's business, is a short-term obligation.

(d) Under §§ 1281(a) and 1283(c), a holder of a short-term obligation subject to § 1281 must include in gross income an amount equal to the sum of the daily portions of the acquisition discount or OID, whichever is applicable, on the obligation for each day during the taxable year that the obligation is held by the holder. See § 1283(b), as modified by § 1283(c), to determine the daily portions of acquisition discount or OID. In addition, § 1281(a) requires the holder to include in gross income any stated interest that is payable on the short-term obligation (other than stated interest taken into account to determine the amount of the acquisition discount or OID) as it accrues.

(2) *Section 481(a) adjustment period.* A taxpayer must take the entire § 481(a) adjustment into account in computing taxable income for the year of change.

.02 *Stated interest on short-term loans of cash method banks in the Eighth Circuit.*

(1) *Description of change and scope.*

(a) This change applies to a cash method bank in the Eighth Circuit that wants to change its method of accounting from accruing stated interest on short-term loans made in the ordinary course of business to using the cash method for that interest. This change was formerly provided in Notice 95–57, 1995–2 C.B. 337.

(b) In *Security Bank Minnesota v. Commissioner,* 994 F.2d 432 (8th Cir. 1993), *aff'g* 98 T.C. 33 (1992), the U.S. Circuit Court of Appeals for the Eighth Circuit held that § 1281 does not require a cash method bank to include in gross income stated interest on short-term loans made in the ordinary course of business as that interest accrues. The Service disagrees with the interpretation of § 1281 in *Security Bank Minnesota* and intends to pursue this issue in other circuits. In light of *Security Bank Minnesota,* however, cash method banks in the Eighth Circuit will be granted permission to change to the cash method of accounting for stated interest on short-term loans made in the ordinary course of business. If this change was made on or before November 6, 1995, the Service will not seek to deny cash method banks in the Eighth Circuit the use of the cash method on the ground that there was an unauthorized change in method of accounting.

(2) *Section 481(a) adjustment period.* A taxpayer must take the entire § 481(a) adjustment into account in computing taxable income for the year of change.

(3) *No ruling protection.* If the Service is later successful in further litigation

on this issue in other circuits, or there is a change in law, then cash method banks in the Eighth Circuit may be required to use an accrual method of accounting for any taxable year not barred by the statute of limitations.

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26 CFR 601.204: Changes in accounting periods and in methods of accounting.

(Also Part I, §§ 446; 1.446–1.)

Rev. Proc. 97–38

SECTION 1. PURPOSE

.01 This revenue procedure implements an administrative decision, made by the Commissioner in the exercise of discretion under section 446 of the Internal Revenue Code. Under this revenue procedure, accrual method manufacturers, wholesalers, and retailers of motor vehicles or other durable consumer goods may, in certain specified and limited circumstances, include a portion of an advance payment related to the sale of a multi-year service warranty contract in gross income generally over the life of the service warranty obligation. A taxpayer may change to or adopt the service warranty income method. The procedures for a taxpayer to change to the service warranty income method are provided in Rev. Proc. 97–37, page 18, which provides simplified and uniform procedures to obtain automatic consent to make this and other changes in methods of accounting. This revenue procedure modifies and supersedes Rev. Proc. 92–98, 1992–2 C.B. 512.

.02 The service warranty income method described in this revenue procedure is the same method of accounting that was described in Rev. Proc. 92–98. Accordingly, a taxpayer that properly changed to or adopted this method pursuant to Rev. Proc. 92–98 is not required to change its method of accounting to comply with this revenue procedure.

SECTION 2. BACKGROUND

.01 In general, payments received by an accrual method taxpayer for services to be performed in the future must be included in gross income in the taxable year of receipt. The Commissioner recognizes that this treatment has resulted in a significant and unique cash flow problem for certain accrual method taxpayers that sell multi-year service warranty contracts to customers in connection with the sale of motor vehicles or other durable consumer goods and immediately pay a third-party to insure their risks under the contracts.

.02 Accordingly, these taxpayers will be permitted to adopt or change to a special method of accounting for advance payments that would alleviate the cash flow problem arising in these situations but would generally conform economically to the tax treatment of advance payments under current law. In general, this method of accounting permits these taxpayers to recognize and include in gross income, generally over the period of their service warranty contracts, a series of equal payments, the present value of which equals the portion of the advance payment qualifying for deferral. This method of accounting is described in further detail in section 5 of this revenue procedure.

SECTION 3. DEFINITIONS

.01 The "service warranty income method" for advance payments is the method of accounting permitted by this revenue procedure and described in section 5 of this revenue procedure.

.02 The "qualified advance payment amount" is the portion of an advance payment received by a taxpayer under a multi-year service warranty contract that is paid by that taxpayer to an unrelated third party within 60 days after receipt for insurance costs associated with a policy insuring that taxpayer's obligations under the contract.

.03 The classification of goods as "durable consumer goods" for purposes of this revenue procedure depends on the common usage of the goods, rather than the purchaser's actual intended use of the goods. Thus, a taxpayer qualifying under this revenue procedure does not have to segregate, as non-qualifying advance payments, those payments under multi-year service warranty contracts entered into with a purchaser that will use the underlying durable consumer goods in its trade or business.

SECTION 4. SCOPE

.01 Except as provided in sections 4.03 and 4.04 of this revenue procedure, the use of the service warranty income method is available to any accrual method manufacturer, wholesaler, or retailer of motor vehicles or other durable consumer goods with respect to qualified advance payment amounts received on service warranty contracts:

(1) that are fixed-term service arrangements with respect to a motor vehicle or other durable consumer good purchased by a customer;

(2) that are separately priced, such that customers have the option to purchase the service warranty contracts for an expressly stated amount separate from the price of the underlying motor vehicle or other durable consumer good;

(3) for which the service period begins in the taxable year the advance payment is received or upon expiration of a fixed-term manufacturer's warranty beginning in the taxable year the advance payment is received;

(4) for which the taxpayer purchases a policy that constitutes insurance for federal income tax purposes from an unrelated third party to insure its obligation under the service warranty contract; and

(5) for which the taxpayer makes payment to the unrelated third party insurer within 60 days after receipt of the advance payment for the entire amount of the insurance costs associated with the policy insuring its obligations under the service warranty contract.

.02 For purposes of section 4.01 of this revenue procedure, a service warranty contract will be treated as a fixed-term arrangement even if the contract provides for a reasonable mileage or other usage cap that is generally commensurate with average consumer mileage or usage over the term of the contract and which causes termination of the fixed-term arrangement when exceeded. Also for purposes of section 4.01 of this revenue procedure, a taxpayer has not made payment to an unrelated third party insurer if the taxpayer and the payee are related persons within the meaning of § 267(b) or 707(b)(1).

.03 A taxpayer is not within the scope of this revenue procedure unless the taxpayer either (1) has never previously received advance payments under service warranty contracts prior to the taxable year of an adoption under this revenue procedure, or (2) uses the proper method

of accounting for advance payments under its service warranty contracts (*see Schlude v. Commissioner*, 372 U.S. 128 (1963), 1963–1 C.B. 99).

.04 A taxpayer also is not within the scope of this revenue procedure unless the taxpayer uses the proper method of accounting for amounts paid or incurred for insurance costs that cover the taxpayer's risks under service warranty contracts. *See* section 5.03 of the APPENDIX of Rev. Proc. 97–37 for a description of that proper method.

SECTION 5. DESCRIPTION OF THE SERVICE WARRANTY INCOME METHOD

.01 *In general.* Taxpayers with an advance payment within the scope of section 4 of this revenue procedure may elect to include a qualified advance payment amount, increased by an imputed income amount, in gross income on a level basis over the shorter of:

(1) the period beginning in the taxable year the advance payment is received and ending when the service warranty contract terminates; or

(2) a 6-taxable-year period beginning in the taxable year the advance payment is received.

This method of accounting permits these taxpayers to recognize and include in gross income, generally over the period of their service warranty contracts, a series of equal payments, the present value of which equals the qualified advance payment amounts received by the taxpayer. A taxpayer using the service warranty income method provided by section 5 of this revenue procedure must include in income, in the taxable year of receipt, the excess of aggregate advance payments received during a taxable year over aggregate qualified advance payment amounts for the taxable year.

.02 *Simplifying table.*

(1) An electing taxpayer must use the table in the APPENDIX of this revenue procedure to determine the amount of the gross income (attributable to a qualified advance payment amount) that must be reported annually under the service warranty income method.

(2) To use the table for a particular contract, a taxpayer first uses the column headed by the "Term of Service Agreement in Years." The taxpayer determines which column to use by ascertaining the length (the number of years) of its service warranty contract (limited to six years) without regard to whether there is a period for which there are no obligations under the contract. For example, if a service warranty contract begins in the third year after payment is received and ends in the fifth year after payment, the taxpayer uses the column headed "5." The taxpayer then finds the factor in the row headed by "The Applicable Interest Rate," which is defined in section 5.04 of this revenue procedure. If the applicable interest rate in this instance is 8 percent, the resulting factor would be .2319. This factor is multiplied by the qualified advance payment amount to determine the "annual equal payment amount" included in gross income each year for the number of years at the top of the column.

(3) A taxpayer may calculate the aggregate amount to be included in gross income each year by aggregating the qualified advance payment amounts with respect to contracts of the same class (that is, 2-year contracts, 3-year contracts, etc.). See section 5.08 of this revenue procedure for examples of the service warranty income method.

.03 *Special rule for when the taxpayer's trade or business ceases.* In the year in which the taxpayer's trade or business ceases (as defined in section 5.02(3) of Rev. Proc. 97–37), the remaining qualified advance payment amounts that have been deferred must be accelerated and included in gross income, along with appropriate imputed income amounts. These amounts must be determined using the applicable interest rates specified in section 5.04 of this revenue procedure and must be sufficient to ensure that the net present value of all amounts included in income over the period of deferral equals the qualified advance payment amounts that would have been reported and included in income upon receipt in the absence of an election under this revenue procedure. See the example in section 5.08(1)(c) of this revenue procedure. The Service will compute the amounts to be included in the year of cessation for any taxpayer that submits a request for a ruling pursuant to Rev. Proc. 97–1, 1997–1 I.R.B. 11 (or any successor). The Service waives the applicable user fee required under Rev. Proc. 97–1 for these requests.

.04 *Applicable interest rate.* The applicable interest rate to be applied to the qualified advance payment amount received for a particular contract in a particular taxable year under the service warranty income method is the applicable federal rate in effect for purposes of § 1274(d) (compounded annually) for the month with or within which the taxable year ends. For purposes of this revenue procedure, the applicable federal rate is rounded to the nearest full percent (or if a multiple of 1/2 of 1 percent, such rate shall be increased to the next highest full percent).

.05 *Effects of the imputed income.* Any income imputed on a qualified advance payment amount under this service warranty income method must not be taken into account for any purpose under the Internal Revenue Code other than the determination of a taxpayer's income. Thus, for example, the income imputed on a qualified advance payment amount may not increase the basis of any asset held by the taxpayer and may not be recovered as a deduction in any taxable year. Additionally, any income imputed on a qualified advance payment amount may not be taken into account, for example, in determining:

(1) the earnings and profits of any corporation under § 312;

(2) the adjustments to a shareholder's stock basis in an S corporation under § 1367;

(3) the adjustments to a partner's interest in a partnership under § 705; or

(4) the investment adjustments (or adjustments to an excess loss account) under § 1.1502–32 of the Income Tax Regulations with respect to the stock of any consolidated group member owned by another member of the group.

.06 *Special rules for customer cancellations of service warranty contracts and terminations of service warranty contracts because of mileage or usage limitations.*

(1) *Customer cancellations.* If a customer cancels a service warranty contract during the taxable year of sale and, in that year, receives a refund of amounts paid, the amount refunded is not included in the taxpayer's income for the year of the sale. If a customer cancels a service warranty contract after the year in which the taxpayer sold the contract, the taxpayer must

continue to include the annual equal payment amount obtained from the APPENDIX table in gross income for the original length of the cancelled contract. Any amount refunded to the customer reduces income in the year paid. Imputed income amounts added to a qualified advance payment amount are not considered in (and have no effect on) the determination of this reduction of income. Thus, reductions for refunds upon customer cancellation of a multi-year service warranty contract are to be determined in the same manner as if the taxpayer did not make an election under this revenue procedure.

(2) *Terminations.* If a contract terminates because of a mileage or usage limitation during or after the year in which the taxpayer sold the contract, the taxpayer must continue to include the annual equal payment amount obtained from the APPENDIX table in gross income for the original length of the terminated contract. See paragraph (b) of Example 1 in section 5.08 of this revenue procedure.

.07 *Short taxable years.* If a taxpayer using the table in the APPENDIX of this revenue procedure has a short taxable year during the term of its service warranty contract, the applicable table factor for the short period must be multiplied by a fraction, the numerator of which is the number of months in the short period, and the denominator of which is 12. After a short taxable year for which the table factor adjustment of the preceding sentence has been made, the taxpayer must continue to determine its gross income on a prior year's qualified advance payment amount using the applicable table factor for each 12-month taxable year (or that table factor multiplied by an appropriate fraction for any other short periods), until the number of months for which the qualified advance payment amount is taken into account (determined as if the qualified advance payment amount is first taken into account in the first month of the year in which the advance payment is received) is equal to the number of months in the original contract term (as determined under section 5.02 of this revenue procedure). If less than 12-months' inclusion remains for the final year, the applicable table factor for that year may be determined as if it were a short period containing the number of months remaining on the contract not yet taken into account. See Example 2 in section 5.08 of this revenue procedure.

.08 *Examples of the service warranty income method.*

(1) *Example 1.*

(a) A, a calendar year accrual basis taxpayer, elects under this revenue procedure to use the service warranty income method of accounting for its qualified advance payment amounts on service warranty contracts. A sold 5 service warranty contracts on January 1, 1997, for $800 each. A also sold 5 service warranty contracts on December 31, 1997, for $800 each. All the service warranty contracts sold by A in 1997 carry a term of 5 years and run concurrently with the manufacturer's warranties. Further, A pays, within 60 days of the receipt of each advance payment, $600 per contract to an unrelated third party to insure (in an arrangement that constitutes insurance) its obligations under the service warranty contracts. The applicable interest rate, determined in accordance with section 5.04 of this revenue procedure, is 10 percent.

A aggregates all its qualified advance payment amounts on its 5-year service warranty contracts, thus determining that $6,000 of qualified advance payment amounts were received in 1997 with respect to the class of 5-year service warranty contracts. Applying the "10% and 5-year" factor of .2398 found in the table in the APPENDIX of this revenue procedure, A determines that it must report gross income of $1,439 ($6,000 x .2398) in 1997 through 2001 under the election provided in this revenue procedure. In addition, A must include in gross income in 1997 the $2,000 payment received for services that is not deferred under this revenue procedure. Gross income is reported by A as follows:

Description of Item	1997	1998	1999	2000	2001
Non-deferred Income	$2,000				
Deferred Income	1,439	$1,439	$1,439	$1,439	$1,439
Gross Income	$3,439	$1,439	$1,439	$1,439	$1,439

Assuming that A is an S corporation with a single shareholder and that A reported no income other than that arising from the above service warranty transactions, the shareholder would report the following § 1367 adjustments to stock basis:

Description of Item	1997	1998	1999	2000	2001
Non-deferred Income	$2,000				
Deferred Income	1,200	$1,200	$1,200	$1,200	$1,200
Gross Income	$3,200	$1,200	$1,200	$1,200	$1,200

The stock basis adjustment for the deferred advance payment amount is determined by ratably spreading the stock basis adjustment over the term of the service warranty contract. Since the service warranty contract is treated as sold at the beginning of the taxable year, the stock basis adjustment each year would be $1,200 ($6,000/5). The aggregate imputed income of $1,195 ($239 x 5) on the $6,000 of aggregate qualified advance payment amounts for 1997 is not taken into account at any time by the shareholder in determining its basis in the A stock.

(b) If one of the service warranty contracts described in paragraph (a) terminates because of a mileage or usage limitation in 1999, there is no effect on the amounts that A must include in gross income each year. Under section 5.06 of this revenue procedure, A would continue to report the amounts of gross income set forth in section 5.08(1)(a) of this revenue procedure even if one or more of its service warranty contracts is terminated.

(c) If A's business ceases in 1999, A must include the $2,000 non-qualified advance payment amount in gross income in 1997 and the $1,439 annual equal payment amount in gross income in 1997 and 1998, as in section 5.08(1)(a) of this revenue procedure above. However, in 1999, A must accelerate and include in gross income the remaining advance payment amount plus an appropriate imputed income amount.

To calculate this amount, A must first determine the portion of the qualified advance payment amount and the portion of

imputed income included in each annual equal payment amount. For 1997, the annual equal payment amount included in income, $1,439, is entirely from the qualified advance payment amount because no income is imputed to the taxpayer in the first taxable year. Thus, the $6,000 deferred qualified advance payment amount is reduced for A's inclusion of $1,439 in 1997 leaving $4,561 of deferred qualified advance payment amount remaining.

For 1998, A multiplies the applicable interest rate of 10% by the 1997 remaining qualified advance payment amount of $4,561. That product, $456, constitutes the imputed income portion of the 1998 annual equal payment amount of $1,439. The difference between $1,439 and $456 ($983) is the portion of the annual equal payment amount that constitutes the qualified advance payment amount. The $983 reduces the qualified advance payment amount remaining after 1997 to $3,578.

When A's business ceases in 1999, A must include in gross income the qualified advance payment amount remaining after 1998 and an appropriate imputed income amount. The appropriate imputed income amount is the product of the qualified advance payment amount remaining after 1998 and the applicable interest rate ($3,578 x 10%), which is $358. Thus, in 1999, A includes in gross income $3,936 ($3,578 + $358).

(2) *Example 2.* X, a calendar year accrual basis taxpayer, elects under this revenue procedure to use the service warranty income method of accounting for its qualified advance payment amounts on service warranty contracts. X sold 5 service warranty contracts on January 1, 1997, for $800 each. X also sold 5 service warranty contracts on December 31, 1997, for $800 each. All the service warranty contracts sold by X in 1997 carry a term of 5 years and run concurrently with the manufacturer's warranties. Further, X pays, within 60 days of the receipt of each advance payment, $600 per contract to an unrelated third party to insure (in an arrangement that constitutes insurance) its obligations under the service warranty contracts. The applicable interest rate, determined in accordance with section 5.04 of this revenue procedure, is 10 percent.

X aggregates all its qualified advance payment amounts on its 5-year service warranty contracts, thus determining that $6,000 of qualified advance payment amounts were received in 1997 with respect to the class of 5-year service warranty contracts. Applying the "10% and 5-year" factor of .2398 found in the table in the APPENDIX of this revenue procedure, X determines that it has annual equal payment amounts of $1,439 includible in gross income in 1997 through 2001 under the election provided in this revenue procedure. In addition, X must include in gross income in 1997 the $2,000 payment received for services that is not deferred as a qualified advance payment amount by this revenue procedure.

After making the initial determinations above, X experiences a short taxable year of 7 months beginning on January l, 1999, and ending on July 31, 1999. After the 7-month short period, X's taxable year ends on July 31. When X experiences the 7-month short period, X must multiply the factor in the table in the APPENDIX of this revenue procedure by a fraction, the numerator of which is the number of the months in the short period, and the denominator of which is 12. This adjusted factor of .1399 (7/12 x .2398) is applied to the qualified advance payment amount of $6,000. The product, $839, is included in X's gross income for the short taxable year. Because X's contracts had a term of 5 years or 60 months (and are assumed under this revenue procedure to have begun at the beginning of the 1997 taxable year), there are 5 additional months in the taxable year ending July 31, 2002, for which a portion of the annual equal payment amount must be taken into account. Thus, X includes $600 (5/12 x .2398 x $6,000) in gross income. Gross income is reported by X in each taxable year as follows:

Description of Item	1997	1998	7-month Short Yr.	Yr. End 7/31/00	Yr. End 7/31/01
Non-deferred Income	$2,000				
Deferred Income	1,439	$1,439	$ 839	$1,439	$1,439
Gross Income	$3,439	$1,439	$ 839	$1,439	$1,439

Description of Item	Yr. End 7/31/02
Non-deferred Income	
Deferred Income	$ 600
Gross Income	$ 600

SECTION 6. CHANGING TO OR ADOPTING SERVICE WARRANTY INCOME METHOD

.01 *Automatic change.* A taxpayer wanting to change its method of accounting to the service warranty income method must follow the provisions of Rev. Proc. 97–37.

.02 *Adoption of method.* A qualifying taxpayer may adopt the service warranty income method in any taxable year ending on or after August 18, 1997 by attaching a statement to its timely filed original federal income tax return (including extensions) for the year of adoption.

.03 *Statement.* The statement referred to in section 6.02 of this revenue procedure should be identified at the top as follows: "ELECTION OF THE SERVICE WARRANTY INCOME METHOD UNDER REV. PROC. 97–38." The statement should set forth:

(1) a paragraph stating that the taxpayer is electing the service warranty income method for all advance payments (as defined in this revenue procedure) received in the current taxable year and to be received in subsequent taxable years;

(2) a paragraph stating that the taxpayer agrees to all the terms and conditions of this Rev. Proc. 97–38, and specifically stating that the taxpayer agrees to include in gross income all imputed income amounts necessary at the applicable interest rate determined in accordance with section 5.04 of this revenue procedure so that the net present value of gross income inclusions in taxable years to which qualified advance payment amounts are being deferred equals the amount of qualified advance payment

amounts received in earlier taxable years;

(3) a description of the service warranty contracts sold during the taxable year the service warranty income method is elected;

(4) the aggregate amount of the qualified advance payment amounts received for each class (3-year contracts, 4-year contracts, etc.) of service warranty contracts sold during the taxable year of election;

(5) the future value factors that are to be applied to the aggregate qualified advance payment amounts for each class of service warranty contracts sold during the election year; and

(6) the signature by or on behalf of the taxpayer making the election by an individual with the authority to bind the taxpayer in such matters. For example, an officer must sign on behalf of a corporation, a general partner on behalf of a state law partnership, a member-manager on behalf of a limited liability company, a trustee on behalf of a trust, or an individual taxpayer on behalf of a sole proprietorship. If the taxpayer is a member of a consolidated group, the statement submitted on behalf of the taxpayer must be signed by a duly authorized officer of the common parent. See section 6.02(4) of Rev. Proc. 97–37.

.04 *Annual reporting requirement.* Upon election of the service warranty income method of accounting, a taxpayer must satisfy an annual reporting requirement. For each taxable year after election of the service warranty income method, the taxpayer must attach a statement to its timely filed original federal income tax return setting forth:

(1) a description of the service warranty contracts sold during the taxable year;

(2) the aggregate amount of the qualified advance payment amounts received for each class of service warranty contracts sold during the taxable year; and

(3) the future value factors that are to be applied to the aggregate qualified advance payment amounts for each class of service warranty contracts sold during the taxable year.

SECTION 7. EFFECT OF AND REVOCATION OF ELECTION

The election of the service warranty income method under this revenue procedure constitutes a change to or adoption of a method of accounting. Because the service warranty income method constitutes a method of accounting, an electing taxpayer must use that method for all its qualified advance payment amounts on service warranty contracts described in section 4.01 of this revenue procedure. The election of the service warranty income method may only be revoked with the consent of the Commissioner. Thus, to request revocation of an election under this revenue procedure, a taxpayer must apply to the Commissioner to change its method of accounting under the procedures prescribed in Rev. Proc. 97–27, 1997–21 I.R.B. 10.

SECTION 8. FAILURE TO COMPLY

Failure of the taxpayer (and, in the case of, for example, an S corporation or partnership, any of its shareholders or partners) to comply with all the requirements of this revenue procedure will constitute grounds for revocation of the service warranty income method election by the Commissioner and may result in revocation of the election by an examining agent beginning in the first open taxable year of noncompliance.

SECTION 9. APPLICABILITY OF REV. PROC. 97–37

The definitions in Rev. Proc. 97–37 apply for purposes of this revenue procedure, except to the extent provided otherwise in this revenue procedure.

SECTION 10. INQUIRIES

Inquiries regarding this revenue procedure may be addressed to the Commissioner of Internal Revenue, Attention: CC:DOM:IT&A, 1111 Constitution Avenue, NW, Washington, DC 20224.

SECTION 11. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 92–98, 1992–2 C.B. 512, is modified, and as modified, is superseded. However, see the transition rules in section 13.02 of Rev. Proc. 97–37.

SECTION 12. EFFECTIVE DATE

This revenue procedure is effective for any taxable year of a qualifying taxpayer ending on or after August 18, 1997.

SECTION 13. PAPERWORK REDUCTION ACT

The collections of information contained in this revenue procedure have been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545–1551.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays

APPENDIX
(Table)

Applicable Interest Rate	Term of Service Agreement in Years					
	1	2	3	4	5	6
1.0%	1.0000	0.5025	0.3367	0.2537	0.2040	0.1708
2.0%	1.0000	0.5050	0.3400	0.2575	0.2080	0.1750
3.0%	1.0000	0.5074	0.3432	0.2612	0.2120	0.1792
4.0%	1.0000	0.5098	0.3465	0.2649	0.2160	0.1834
5.0%	1.0000	0.5122	0.3497	0.2686	0.2200	0.1876
6.0%	1.0000	0.5146	0.3529	0.2723	0.2240	0.1919
7.0%	1.0000	0.5169	0.3561	0.2759	0.2279	0.1961
8.0%	1.0000	0.5192	0.3593	0.2796	0.2319	0.2003
9.0%	1.0000	0.5215	0.3624	0.2832	0.2359	0.2045
10.0%	1.0000	0.5238	0.3656	0.2868	0.2398	0.2087
11.0%	1.0000	0.5261	0.3687	0.2904	0.2438	0.2130
12.0%	1.0000	0.5283	0.3717	0.2940	0.2477	0.2172
13.0%	1.0000	0.5305	0.3748	0.2975	0.2516	0.2214
14.0%	1.0000	0.5327	0.3778	0.3011	0.2555	0.2256
15.0%	1.0000	0.5349	0.3808	0.3046	0.2594	0.2298

a valid OMB control number.

The collections of information in this revenue procedure are in section 6. This information is necessary and will be used to determine whether the taxpayer is properly using the service warranty income method. The collections of information are required for the taxpayer to use the service warranty income method. The likely respondents are the following: individuals, business or other for-profit institutions, and small businesses or organizations.

The estimated total annual reporting burden is 5,000 hours.

The estimated annual burden per respondent varies from 2 hours to 3 hours, depending on individual circumstances, with an estimated average of 2.5 hours. The estimated number of respondents is 2,000.

The estimated annual frequency of responses is once.

Books or records relating to a 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.

DRAFTING INFORMATION

This revenue procedure was drafted in the Office of Assistant Chief Counsel (Income Tax & Accounting). For further information regarding this revenue procedure, contact Michael F. Schmit on (202) 622-4960 (not a toll free call).

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26 CFR 601.204: Changes in accounting periods and in methods of accounting.

(Also Part I, §§ 1273; 1.1273–1, 1.1273–2.)

Rev. Proc. 97–39

SECTION 1. PURPOSE

.01 This revenue procedure allows a taxpayer to use the principal-reduction method of accounting — an aggregate method of accounting for de minimis original issue discount on certain loans originated by the taxpayer. The principal-reduction method is based on the rule that, if a taxpayer holds a debt instrument with de minimis original issue discount, the taxpayer must include that discount in income as stated principal payments are made. *See* § 1.1273–1(d)(5) of the Income Tax Regulations. A taxpayer may change to or adopt the principal-reduction method. The procedures for a taxpayer to change to the principal-reduction method are provided in Rev. Proc. 97–37, page 18, which provides simplified and uniform procedures to obtain automatic consent to make this and other changes in methods of accounting. This revenue procedure modifies and supersedes Rev. Proc. 94–29, 1994–1 C.B. 616.

.02 The principal-reduction method described in this revenue procedure is the same method of accounting that was described in Rev. Proc. 94–29. Accordingly, a taxpayer that properly changed to or adopted this method pursuant to Rev. Proc. 94–29 is not required to change its method of accounting to comply with this revenue procedure.

SECTION 2. BACKGROUND

.01 A debt instrument (loan) is issued with original issue discount (OID) if the loan's issue price is less than its stated redemption price at maturity. See § 1273(a)(1) of the Internal Revenue Code. In some cases, although a loan is issued with OID, the amount of OID is treated as zero. *See* § 1273(a)(3) and § 1.1273–1(d) (concerning de minimis OID).

.02 Points treated as paid when a loan is originated generally reduce the issue price of the loan. *See* § 1.1273–2(g) (concerning the effect of certain cash payments on the issue price of a loan). Thus, all points charged on a loan create or increase OID on the loan. As used in this revenue procedure, the term "points" refers only to amounts charged for the use or forbearance of money.

.03 Section 1.1272–3 allows a holder of a debt instrument to elect to use a constant yield method to account for all interest that accrues on the instrument. For purposes of this election, interest includes stated interest, acquisition discount, OID, de minimis OID, market discount, de minimis market discount, and unstated interest, as adjusted by any amortizable bond premium or acquisition premium. A holder may make the election only for a debt instrument acquired on or after April 4, 1994. Section 1.1272–3(d) provides rules for the time and manner of making the election under § 1.1272–3.

.04 Section 6001 and the regulations thereunder require taxpayers to keep permanent books of account or records to establish the amount of gross income for a taxable year.

SECTION 3. SCOPE

The principal-reduction method (described in section 5 of this revenue procedure) applies only to loans that—

(1) are acquired by the taxpayer at origination,

(2) do not have OID or, because the OID is de minimis under § 1.1273–1(d), are treated as not having OID,

(3) are not issued at a premium,

(4) are not subject to the election under § 1.1272–3, and

(5) produce ordinary gain or loss when sold or exchanged by the taxpayer.

SECTION 4. USE OF THE PRINCIPAL-REDUCTION METHOD

.01 *Permissibility.*

(1) *In general.* The principal-reduction method of accounting (described in section 5 of this revenue procedure) is a permissible method for use by taxpayers to account for de minimis OID (discount) on one or more categories of loans described in section 4.02 or 4.03 of this revenue procedure. If the principal-reduction method is used to account for any loans in a category of loans, the method must be used for the entire category of loans. As is more fully described in section 5 of this revenue procedure, if the method is used for more than one category, separate data for each category must be kept, and the computations must be made separately for each category.

(2) *Adopting principal-reduction method.* If a taxpayer does not already have a method of accounting for discount on one or more categories of loans, the taxpayer may adopt the principal-reduction method for discount on all or any of those categories of loans by using it on a federal income tax return. The taxpayer must attach to this return a statement identifying the categories of loans to which the new method will apply and describing any "additional categories" permitted under section 4.03 of this revenue procedure.

(3) *Changes to principal-reduction method.* A taxpayer wanting to change to the principal-reduction method must follow the provisions of Rev. Proc. 97–37.

.02 *Standard categories of loans.* The

standard categories of loans are:

Category (1). Loans that are secured by 1- to 4-family residential real property and are not home equity lines of credit or construction loans.

Category (2). Construction loans with original terms not greater than three years.

Category (3). Loans that are secured by real property, are not contained in category (1) or (2), and are not home equity lines of credit.

Category (4). Loans that are consumer loans with original terms not greater than seven years, are not secured by real property, and are not revolving credit loans.

.03 *Additional categories of loans.* The principal-reduction method also may be used for discount on loans that are described in section 3 of this revenue procedure but are not in one of the standard categories described in section 4.02 of this revenue procedure. This use is permissible, however, only if the taxpayer defines one or more additional categories of loans that are sufficiently homogeneous so that use of the principal- reduction method for those additional categories clearly reflects the taxpayer's income. In particular, each additional category must consist solely of loans of comparable duration. For this purpose, duration means the weighted average time to expected payments of principal (including expected prepayments of principal). The weighted average is computed using the present value at issue of the expected payments and prepayments.

SECTION 5. PRINCIPAL-REDUCTION METHOD OF ACCOUNTING

Under the principal-reduction method of accounting for discount —

.01 As of the date each loan in a category is acquired, the taxpayer's basis in the loan is deemed to be the loan's stated principal amount. All the gain represented by the discount on the loan is recognized solely under the principal-reduction method described in this revenue procedure.

.02 The required computations must be made monthly. Thus, the computation period referred to in this revenue procedure is the month (or that portion of a month that falls within a short taxable year).

.03 At the start of each computation period, the taxpayer must record and retain the following information for each category of loans for which the taxpayer is using the principal-reduction method:

(1) Unpaid stated principal as of the end of the prior period of all loans in the category that were held at the end of the prior period (Starting Principal); and

(2) Unrecognized discount as of the end of the prior period (Starting Discount).

For the initial computation period, Starting Principal and Starting Discount are zero.

.04 During each computation period, the taxpayer must record and retain the following information for each category of loans for which the taxpayer is using the principal-reduction method:

(1) The stated principal amount at the time of acquisition of all loans in the category that were acquired at origination by the taxpayer at any time during the period, whether or not they are still held by the taxpayer at the end of the period (Current Principal). This amount includes loans in the category that are acquired as refinancings of, or in exchange for, loans previously held by the taxpayer. Thus, if a loan (whether or not in the category) is modified and the modification results under § 1001 in a deemed sale or exchange of the old loan for a new one that is in the category, the stated principal amount of the new loan is included in Current Principal.

(2) The aggregate discount (including discount attributable to points) at the time of acquisition on all loans described in section 5.04(1) of this revenue procedure (Current Discount).

(3) The unpaid stated principal amount of all loans in the category that are still held by the taxpayer at the end of the period (Ending Principal). Thus, Ending Principal does not include the stated principal amount of loans disposed of in refinancings or exchanges during the period. Ending Principal does not include rights (such as mortgage servicing rights) that are retained on the sale of a loan, except to the extent that those rights represent a participation interest in the stated principal amount of the original loan. Ending Principal does not include the stated principal amount of any loan to the extent charged off by the taxpayer during the period. Except as provided in the following sentence, if the taxpayer has foreclosed on the property securing a loan, neither the unpaid stated principal on the loan nor any remaining deficiency on the loan is counted as part of Ending Principal. If property securing a loan is acquired in a transaction governed by former § 595 and the property has not been disposed of before the end of the period, Ending Principal includes the unpaid stated principal of the loan immediately before the transaction in which the property was acquired.

.05 The discount taken into account as gain (Recognized Discount) during each computation period is the portion of total discount that corresponds to the portion of principal recovered during the period. For this purpose, Recognized Discount is the product of the sum of Starting Discount plus Current Discount times a fraction the denominator of which is the sum of Starting Principal plus Current Principal and the numerator of which is the excess of the denominator over Ending Principal. This can be restated as:

$$R = (D_{Start} + D_{Current}) \times ([P_{Start} + P_{Current} - P_{End}] / [P_{Start} + P_{Current}])$$

where —

P_{Start} = Starting Principal
D_{Start} = Starting Discount
$P_{Current}$ = Current Principal
$D_{Current}$ = Current Discount
P_{End} = Ending Principal
R = Recognized Discount

.06 The unrecognized discount at the end of the period (Ending Discount) is the excess of the sum of Starting Discount plus Current Discount over Recognized Discount. This amount must be used as Starting Discount for the next period. This can be restated as:

$$D_{End} = D_{Start} + D_{Current} - R$$

where —

D_{End} = Ending Discount

.07 Ending Principal for the current period must be used as Starting Principal for the following period.

.08 The discount recognized as gain during a taxable year is the sum of the Recognized Discount for all computation periods comprising the year.

.09 For each period, the amounts referred to above must be recorded and sep-

arately retained as part of the taxpayer's tax books and records. *See* § 6001 and the regulations thereunder. These records must be maintained as separate tax records and not merely as a set of adjustments to book figures. These records must affirmatively demonstrate the period-to-period consistency required by sections 5.06 and 5.07 of this revenue procedure.

SECTION 6. EXAMPLE

.01 *T* properly adopts the method described in section 5 of this revenue procedure for all the loans that it acquires that are described in Category (1) in section 4.02 of this revenue procedure.

.02 For *T*'s first month in operation, it acquired at origination loans in Category (1) with an aggregate stated principal amount of $10,000,000 at the time of acquisition. The sum of the discount with which these loans were acquired is $400,000. At the end of the month, $9,000,000 was the outstanding stated principal amount on the Category (1) loans still held by *T*. Thus, the discount recognized during the month is $40,000. That figure is derived as follows:

$R = (D_{Start} + D_{Current}) \times ([P_{Start} + P_{Current} - P_{End}] / [P_{Start} + P_{Current}])$

= ($0 + $400,000) x ([$0 + $10,000,000 - $9,000,000] / [$0 + $10,000,000])

= ($400,000) x ($1,000,000 / $10,000,000)

= $400,000 x 0.1

= $40,000

The amount of unrecognized discount at the end of the month is $360,000. This figure is derived as follows:

$D_{End} = D_{Start} + D_{Current} - R$

= $0 + $400,000 – $40,000

= $360,000

.03 In the second month of operation, T acquired at origination $23,000,000 in Category (1) loans with a total of $760,000 in discount at the time of acquisition. At the end of the month, $28,000,000 was the outstanding stated principal amount on Category (1) loans still held by T. Thus, the discount recognized during the second month is $140,000. This figure is derived as follows:

$R = (D_{Start} + D_{Current}) \times ([P_{Start} + P_{Current} - P_{End}] / [P_{Start} + P_{Current}])$

= ($360,000 + $760,000) x ($9,000,000 + $23,000,000 – $28,000,000) / ($9,000,000 + $23,000,000)

= $1,120,000 x ($4,000,000 / $32,000,000)

= $1,120,000 x 0.125

= $140,000

The amount of unrecognized discount at the end of the month is $980,000 of discount. This figure is derived as follows:

$D_{End} = D_{Start} + D_{Current} - R$

= $360,000 + $760,000 – $140,000

= $980,000

SECTION 7. INTERACTION WITH § 475

If a loan is subject to both the mark-to-market rules under § 475 and the principal-reduction method, see Notice 96–23, 1996–1 C.B. 374.

SECTION 8. INQUIRIES

Inquiries regarding this revenue procedure may be addressed to the Commissioner of Internal Revenue, Attention: CC:DOM:FI&P, 1111 Constitution Avenue, NW, Washington, DC 20224.

SECTION 9. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 94–29, 1994–1 C.B. 616, is modified, and as modified, is superseded. However, see the transition rules in section 13.02 of Rev. Proc. 97–37.

SECTION 10. EFFECTIVE DATE

This revenue procedure is effective on August 18, 1997.

SECTION 11. PAPERWORK REDUCTION ACT

The collections of information contained in this revenue procedure have been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545–1551.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid OMB control number.

The collections of information in this revenue procedure are in sections 4 and 5. This information is necessary and will be used to determine whether the taxpayer properly has adopted the principal-reduction method of accounting. The collections of information are required for the taxpayer to use the principal-reduction method of accounting. The likely respondents are business or other for-profit institutions.

The estimated total annual reporting and/or recordkeeping burden is 3,650 hours.

The estimated annual burden per respondent/record keeper varies from 12 hours to 14 hours depending on individual circumstances, with an estimated average of 12 hours. The estimated number of respondents and/or recordkeepers is 350.

The estimated annual frequency of responses is on occasion.

Books or records relating to a 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.

DRAFTING INFORMATION

This revenue procedure was drafted in the Office of Assistant Chief Counsel (Financial Institutions and Products). For further information regarding this revenue procedure, contact

William E. Blanchard on (202) 622-3950 (not a toll free call).

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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 I, § 1362; 1.1362–6.)

Rev. Proc. 97–40

SECTION 1. PURPOSE

This revenue procedure provides guidance under § 1362(b)(5) of the Internal Revenue Code for requesting relief for late S corporation elections that are filed within 6 months of the due date of the election.

SECTION 2. BACKGROUND

Section 1361(a)(1) defines an "S corporation," with respect to any taxable year, as a small business corporation for which an S election is in effect for that year.

Section 1362(a)(1) provides that, except in a situation described in § 1362(g), a small business corporation may elect to be treated as an S corporation.

Section 1362(b)(1) provides that the corporation may make an election to be treated as an S corporation (A) at any time during the preceding taxable year, or (B) at any time during the taxable year and on or before the 15th day of the 3rd month of the taxable year. Under § 1362(b)(3), if an S corporation election is made for a taxable year after the 15th day of the 3rd month of that taxable year and on or before the 15th day of the 3rd month of the following taxable year, then the S corporation election is treated as made for the following taxable year.

Section 1362(b)(5) provides that if (A) an election under § 1362(a) is made for any taxable year (determined without regard to § 1362(b)(3)) after the date prescribed by § 1362(b) for making the election for the taxable year or no election is made for any taxable year, and (B) the Secretary determines that there was reasonable cause for the failure to timely make the election, the Secretary may treat the election as timely made for the taxable year (and § 1362(b)(3) shall not apply).

SECTION 3. SCOPE

This revenue procedure provides a special procedure to request relief for a late S corporation election. This revenue procedure applies only to a corporation (1) that has not filed a timely S corporation election under § 1362(a)(1), and (2) for which an S corporation election is filed within 6 months of the original due date for the election. This revenue procedure does not provide relief for late shareholder elections including a qualified subchapter S trust (QSST) election or electing small business trust (ESBT) election. This special procedure is in lieu of the letter ruling procedure that is used to obtain relief for a late S corporation election under § 1362(b)(5). Accordingly, user fees do not apply to corrective action under this revenue procedure. A corporation that is not eligible for relief under this revenue procedure, or is denied relief, may request relief by applying for a private letter ruling. The procedural requirements for requesting a private letter ruling are described in Rev. Proc. 97–1, 1997–1 I.R.B. 11 (or its successor).

SECTION 4. RELIEF FOR LATE S CORPORATION ELECTIONS UNDER THIS REVENUE PROCEDURE

.01 *Eligibility for Relief.* A corporation is eligible for relief if it meets the following requirements:

(1) The corporation fails to qualify as an S corporation solely because the Form 2553 (Election by a Small Business Corporation) was not filed timely pursuant to § 1362(b)(1); and

(2) The due date for the tax return (excluding extensions) for the first year the corporation intended to be an S corporation has not passed.

.02 *Procedural Requirements for Relief.* Within 6 months of the original due date for the S corporation election, the corporation must file with the applicable service center a completed Form 2553, signed by an officer of the corporation authorized to sign and all persons who were shareholders (or deemed to have been shareholders) at any time during the period that began on the first day of the taxable year for which the election is to be effective and ends on the day the election is made. The Form 2553 must state at the top of the document "FILED PURSUANT TO REV. PROC. 97–40." Attached to the Form 2553 must be a statement explaining the reason for the failure to file a timely S corporation election.

.03 *Relief for Late S Corporation Elections.* Upon receipt of a completed application requesting relief under this revenue procedure, the Internal Revenue Service will determine if there was reasonable cause for the failure to file a timely S corporation election and will notify the corporation of the result of the reasonable cause determination.

SECTION 5. EFFECTIVE DATE

This revenue procedure is effective for all applications for relief satisfying the requirements of section 4 of this revenue procedure, including those applications now being considered by the Service.

SECTION 6. PAPERWORK REDUCTION ACT

The collection of information contained in this revenue procedure has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545–1548.

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

The collection of information in this revenue procedure is in Section 4.02. This information is required to be submitted to the applicable service center in order to obtain relief for late S corporation elections. This information will be used to determine if the reasonable cause requirement in § 1362(b)(5) has been met. The collection of information is required to obtain a benefit. The likely respondents are business or other for-profit institutions.

The estimated total annual reporting burden is 200 hours.

The estimated annual burden per respondent varies from .5 hours to 1.5 hours, depending on individual circumstances, with an estimated average of 1 hour. The estimated number of respondents is 200.

The estimated annual frequency of responses is one.

Books or records relating to a 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.

DRAFTING INFORMATION

The principal author of this revenue procedure is Mark D. Harris of the Office of Assistant Chief Counsel (Passthroughs and Special Industries). For further information regarding this revenue procedure contact Mr. Harris at (202) 622-3050 (not a toll-free call).

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26 CFR 601.601: Rules and regulations.
(Also, Part I, §§ 401, 403; 1.401(b)–1.)

Rev. Proc. 97–41

SECTION 1. PURPOSE

.01 This revenue procedure provides

guidance to sponsors of pension, profit-sharing and stock bonus plans qualified under § 401(a) or 403(a) of the Internal Revenue Code (qualified plans) and tax-sheltered annuity plans described in § 403(b) (§ 403(b) plans) with respect to the date by which they must adopt amendments to comply with changes in the law made by the Small Business Job Protection Act of 1996, Pub. L. 104–188 (SBJPA), the Uruguay Round Agreements Act, Pub. L. 103–465 (GATT), and the Uniformed Services Employment and Reemployment Rights Act of 1994, Pub. L. 103–353 (USERRA). This revenue procedure provides that:

1 In general, there is a single deadline for adopting SBJPA, GATT and USERRA amendments to qualified plans.

2 The deadline for adopting SBJPA, GATT and USERRA amendments is the same as the date by which certain plans that have extended reliance on Tax Reform Act of 1986 (TRA '86) determination letters must be amended.

3 Plan sponsors are allowed, for qualification purposes, to anticipate in plan operation certain plan amendments that they intend to adopt as a result of changes in the qualification requirements.

.02 Specifically, under this revenue procedure:

1 Qualified plans have a remedial amendment period under § 401(b) with respect to certain amendments for SBJPA, GATT or USERRA through the last day of the first plan year beginning on or after January 1, 1999. Thus, these amendments will not have to be adopted before the last day of a plan's 1999 plan year.

2 The deadline for adopting plan amendments to reflect certain limitations under § 415(b), as amended by GATT and SBJPA, is also the last day of the first plan year beginning on or after January 1, 1999. In addition, relief is provided so that a plan amendment described in § 1449(d)(2) of SBJPA repealing an earlier plan amendment that implemented certain amendments made by GATT to § 415(b) need not be adopted before the last day of the first plan year beginning on or after January 1, 1999.

3 Plan sponsors are advised of the Service's intention to publish procedures for obtaining determination letters that include consideration of the changes to the qualification requirements made by SBJPA and GATT as soon as possible after necessary guidance is issued.

4 Amendments for SBJPA to § 403(b) plans, or to annuity contracts purchased under § 403(b) plans, are not required to be adopted before the first day of the first plan year beginning on or after January 1, 1998.

PART I. BACKGROUND

SECTION 2. SBJPA

.01 SBJPA changed several of the requirements of the Code that apply to pension, profit-sharing and stock bonus plans qualified under § 401(a) or 403(a). While a number of these changes are effective in plan years beginning after December 31, 1996, others are not effective until later years.

.02 Section 1465 of SBJPA generally provides an extended period for amending plans and annuity contracts as required by SBJPA. Under § 1465, if any provision of subtitle D (Pension Simplification) of SBJPA requires an amendment to any plan or annuity contract, the amendment is not required to be made before the first day of the first plan year beginning on or after January 1, 1998, provided (1) the amendment is made effective retroactively to the date on which the provision of SBJPA became effective with respect to the plan or contract and (2) the plan or contract is operated in accordance with the requirements of the provision as of its effective date. For a governmental plan (as defined in § 414(d) of the Code), the year "2000" is substituted for the year "1998" in § 1465. Section 1465 applies to plans and contracts in existence on or after the date of enactment of SBJPA, August 20, 1996.

.03 In Rev. Proc. 96–49, 1996–43 I.R.B. 74, the Service stated that plan amendments to reflect the provisions of USERRA and § 414(u), which was added by § 1704(n) in subtitle G (Technical Corrections) of SBJPA, are not required to be made before the date plan amendments are required to be made under § 1465 of SBJPA.

SECTION 3. GATT

.01 GATT, which was enacted December 8, 1994, also changed several of the Code's qualification requirements. These included the rules relating to the determination of certain benefits under §§ 411(a)-(11)(B), 415(b)(2)(E) and 417(e)(3).

.02 The changes to §§ 411(a)(11)(B) and 417(e)(3), relating to the determination of the present value of certain plan distributions, were generally effective for plan years beginning after December 31, 1994. However, § 767(a)(2) of GATT provided a transition rule with respect to the determination under §§ 411(a)(11)(B) and 417(e)(3) of the present value of distributions from plans that were adopted and in effect as of December 7, 1994 ("pre-GATT plans"). In general, under this transition rule, the present value of a distribution from a pre-GATT plan that is made before the earlier of (i) the first plan year beginning after December 31, 1999, or (ii) the later of the adoption or effective date of a plan amendment applying the GATT changes to §§ 411(a)-(11)(B) and 417(e)(3) to the plan is to be determined under the plan's pre-GATT terms. Thus, for pre-GATT plans, amendments applying the GATT changes to §§ 411(a)-(11)(B) and 417(e)(3) to the plan cannot be adopted retroactively. As a result, these plans are not permitted to operate in accordance with these changes prior to the adoption of plan amendments.

.03 Under section 767(d) of GATT, the changes to § 415(b)(2)(E), relating to required adjustments to certain benefits for limitation purposes, were effective for limitation years beginning after December 31, 1994. In addition, § 767(d) of GATT required plans to be operated in accordance with the GATT changes to § 415(b)(2)(E) as of the first limitation year beginning after December 31, 1994, even though, under § 767(d)(3)(B) of GATT, plan amendments applying these changes to the plan would not be required until such date as the Secretary provides.

.04 Section 1449 of SBJPA amended § 767(d)(3)(A) of GATT, however, to permit plan sponsors to delay the implementation of the GATT changes to § 415(b)(2). Section 1449 provides that a pre-GATT plan is not required to apply the GATT changes to § 415(b)(2)(E) with respect to benefits accrued before the earlier of (i) the later of the date a plan amendment applying the changes is adopted or effective or (ii) the first day of the first limitation year beginning

after December 31, 1999. Further, § 1449(d) of SBJPA provides that an amendment applying specified GATT changes that was adopted or effective before August 20, 1996, will be disregarded in applying § 767(d)(3)(A) of GATT, as modified by § 1449(a) of SBJPA, if that amendment is repealed by another plan amendment that is adopted no later than August 20, 1997.

SECTION 4. THE REMEDIAL AMENDMENT PERIOD UNDER SECTION 401(B)

.01 Section 401(b) provides a remedial amendment period during which a plan may be amended retroactively, under certain circumstances, to comply with the Code's qualification requirements. Temporary and proposed amendments to the regulations under § 401(b) were published in the Federal Register on August 1, 1997. Section 1.401(b)–1(f) of the regulations grants the Commissioner the discretion to extend the remedial amendment period. Absent such an extension, however, the remedial amendment period is generally determined as described below.

.02 Section 1.401(b)–1 provides that a plan that fails to satisfy the requirements of § 401(a) solely as a result of a disqualifying provision defined under § 1.401(b)–1(b) need not be amended to comply with those requirements until the last day of the remedial amendment period with respect to the disqualifying provision, provided the amendment is made retroactively effective to the beginning of the remedial amendment period. Under § 1.401(b)–1T(b)(3), a disqualifying provision includes a plan provision designated, at the Commissioner's discretion, as a disqualifying provision that either (i) results in the failure of the plan to satisfy the qualification requirements of the Code by reason of a change in those requirements; or (ii) is integral to a qualification requirement of the Code that has been changed. For this purpose, § 1.401(b)–1T(c)(1) provides that a disqualifying provision includes the absence from a plan of a provision required by or, if applicable, integral to the applicable change in the qualification requirements of the Code, if the plan was in effect on the date the change in those requirements became effective with respect to the plan.

.03 For a disqualifying provision described in § 1.401(b)–1T(b)(3), the remedial amendment period generally begins with the date on which the change becomes effective with respect to the plan or, in the case of a provision that is integral to a qualification requirement that has been changed, the first day on which the plan was operated in accordance with the provision as amended. The remedial amendment period for a disqualifying provision described in §1.401(b)–1T(b)-(3) generally ends with the later of (1) the due date (including extensions) for filing the income tax return for the employer's taxable year that includes the date on which the remedial amendment period begins or (2) the last day of the plan year that includes the date on which the remedial amendment period begins. A plan maintained by more than one employer need not be amended until the last day of the tenth month following the last day of the plan year in which the remedial amendment period begins.

.04 Section 1.401(b)–1 also provides that in the case of a new plan which contains (or fails to contain) a provision that causes the plan to fail to satisfy the requirements of § 401(a) as of the date the plan is put into effect, the plan need not be amended to comply with those requirements until the later of the due date including extensions for filing the employer's tax return for the taxable year in which the plan is put into effect or the last day of the plan year in which the plan is put into effect. A new plan maintained by more than one employer need not be amended until the last day of the tenth month following the last day of the plan year in which falls the date the plan is put into effect.

.05 Section 1.401(b)–1 also provides that in the case of an amendment to an existing plan which causes the plan to fail to satisfy the requirements of § 401(a) as of the date the amendment is adopted or effective (whichever is earlier), the plan need not be amended to correct the amendment until the later of the due date for filing the employer's tax return (including extensions) for the taxable year in which the amendment is adopted or effective (whichever is later) or the last day of the plan year in which the amendment is adopted or effective (whichever is later). In the case of an amendment to an existing plan maintained by more than one employer, the plan need not be amended until the last day of the tenth month following the last day of the plan year in which the amendment is adopted or effective (whichever is later).

SECTION 5. EXTENDED RELIANCE

.01 Under Rev. Proc. 89–9, 1989–1 C.B. 780, Rev. Proc. 89–13, 1989–1 C.B. 801 (both as modified by Rev. Proc. 93–9, 1993–1 C.B. 474), Rev. Proc. 93–39, 1993–2 C.B. 513, Announcement 94–85, 1994–26 I.R.B. 23, and Rev. Proc. 95–12, 1995–1 C.B. 508, plans that were submitted to the Service within certain deadlines for determination, opinion, or notification letters under the Tax Reform Act of 1986, Pub. L. 99–514 (TRA '86), and received favorable letters are entitled to extended reliance. During the extended reliance period, a plan is generally not required to operationally comply with or be amended for regulations or administrative guidance of general applicability issued after the date of the plan's letter which interpret the qualification requirements in effect when the letter was issued. The extended reliance period continues until the earlier of the last day of the last plan year commencing prior to January 1, 1999, or the date established for plan amendment by any legislation that is effective after the date of the plan's letter.

PART II. TIME FOR AMENDING QUALIFIED PLANS FOR SBJPA, GATT, AND USERRA

SECTION 6. DESIGNATION OF CERTAIN PLAN PROVISIONS RELATING TO SBJPA, GATT AND USERRA CHANGES AS DISQUALIFYING PROVISIONS

.01 Pursuant to the Commissioner's authority under § 1.401(b)–1T(b)(3), a plan provision is hereby designated as a disqualifying provision under § 1.401(b)–1(b) if the plan provision causes a plan to fail to satisfy the qualification requirements of the Code because of changes made to those requirements by SBJPA or GATT that are effective before the first day of the first plan year beginning on or after January 1, 1999.

.02 A plan provision is also hereby designated as a disqualifying provision if the plan provision is integral to a qualifi-

cation requirement changed by SBJPA, but only to the extent the change in the qualification requirement is effective before the first day of the first plan year beginning on or after January 1, 1999, and the plan provision as amended is effective prior to the end of the remedial amendment period as described in section 6.04, below. For purposes of this paragraph, the changes in the qualification requirements made by SBJPA include § 414(u) and USERRA. In accordance with § 1.401(b)–1T(d)(1)(v), an amendment of a disqualifying provision described in this paragraph may be made retroactively effective only to the first day on which the plan was operated in accordance with the provision. For example, Announcement 97–24, 1997–11 I.R.B. 24, and Announcement 97–70, 1997–29 I.R.B. 14, provide that an employer may offer certain employees an option to defer commencement of benefits under its qualified plan provided the employer amends the plan retroactively to conform the plan to its pre-amendment operation regarding the option to defer. These announcements also state that future guidance will provide the date by which such a retroactive amendment must be adopted. The retroactive amendment described in Announcements 97–24 and 97–70 is an amendment to a plan provision that is integral to a qualification requirement changed by SBJPA and must therefore be adopted by the end of the remedial amendment period as described below. Generally, plan provisions reflecting the family aggregation rules as in effect prior to 1997 would also be integrally related to SBJPA qualification changes. See section 6.09.

.03 A plan provision that causes a plan to fail to satisfy § 401(a) because of a change made by SBJPA or GATT to the qualification requirements that is effective on or after the first day of the first plan year beginning on or after January 1, 1999, is not a disqualifying provision under section 6.01. A plan provision that is integral to a qualification requirement changed by SBJPA is not a disqualifying provision under section 6.02 if the change in the qualification requirement is effective on or after the first day of the first plan year beginning on or after January 1, 1999, or if the plan provision as amended is not effective prior to the end of the remedial amendment period as described in section 6.04, below. Thus, for example, § 401(b) and the regulations thereunder would not apply to permit the adoption of the § 401(k) and § 401(m) safe harbors described in § 1433(a) and (b) of SBJPA on a retroactive basis, because the provisions of § 1433(a) and (b) are effective for plan years beginning after December 31, 1998. A plan provision that is integral to the limitation under § 415(e), which was repealed by § 1452(a) of SBJPA effective for limitation years beginning after December 31, 1999, also is not a disqualifying provision under section 6.02.

.04 Pursuant to the Commissioner's authority under § 1.401(b)–1(f), with respect to plans other than governmental plans, the remedial amendment period for disqualifying provisions described in sections 6.01 and 6.02 is hereby extended to the last day of the first plan year beginning on or after January 1, 1999. Thus, for example, a single employer calendar year nongovernmental plan that does not satisfy the requirements of § 401(a) because of a disqualifying provision described in section 6.01 or 6.02 may be retroactively amended to meet those requirements by December 31, 1999. For governmental plans, the remedial amendment period for disqualifying provisions described in sections 6.01 and 6.02 is extended to the later of (i) the first day of the first plan year beginning on or after January 1, 2000, or (ii) the last day of the first plan year beginning on or after the "1999 legislative date" (that is, the 90th day after the opening of the first legislative session beginning on or after January 1, 1999, of the governing body with authority to amend the plan, if that body does not meet continuously).

.05 In addition, the remedial amendment period with respect to all disqualifying provisions of new plans adopted or effective after December 7, 1994, and all disqualifying provisions of existing plans arising from a plan amendment adopted after December 7, 1994, that causes the plan to fail to satisfy the requirements of § 401(a) as of the date the amendment is adopted or effective (whichever is earlier), will not expire earlier than the last day of the first plan year beginning on or after January 1, 1999. For a governmental plan, this period will not expire before the later of (i) the first day of the first plan year beginning on or after January 1, 2000, or (ii) the last day of the first plan year beginning on or after the 1999 legislative date.

.06 Although plan amendments are not required before the end of the remedial amendment period, plan sponsors must operate their plans in compliance with the provisions of SBJPA or GATT prior to the time plan amendments are required to the extent earlier operational compliance is required by law or regulation or by revenue ruling, notice or other guidance published in the Internal Revenue Bulletin. In these cases, any retroactive amendments will have to reflect the choices the plan sponsor has already made in the operation of the plan. The following are examples where earlier operational compliance is required.

1 Section 1465 of SBJPA generally requires plans to be operated in compliance with any provision of SBJPA that is effective before the first day of the first plan year beginning on or after January 1, 1998 (or January 1, 2000, in the case of a governmental plan), as of such provision's effective date.

2 Section 401(m)(6)(A) requires correction of excess aggregate contributions to § 401(m) plans to be accomplished within 12 months of the end of the plan year in which the contributions were made. Thus, to this extent, for example, a sponsor of a § 401(m) plan will have to operate the plan in a manner that satisfies § 401(a) as amended by SBJPA and any retroactive amendments must reflect the choices that the plan sponsor has already made in the operation of the plan (for example, the definition of highly compensated employee).

3 Section 1.401(b)–1T(d)(1)(v) permits a remedial amendment of a disqualifying provision that is integral to a qualification requirement changed by SBJPA (including § 414(u) and USERRA) to be made retroactively effective only to the first day on which the plan was operated in accordance with the provision as amended.

.07 Earlier plan amendment may be required by law or regulation or by revenue ruling, notice or other guidance published in the Internal Revenue Bulletin. In these cases plan sponsors may

not rely on the remedial amendment period as a basis for making an amendment retroactively effective. The following are examples where the remedial amendment period may not be relied on as a basis for making an amendment retroactively effective.

1 Except as provided in Rev. Proc. 97–9, 1997–2 I.R.B. 55, a plan sponsor may not retroactively amend a § 401(k) plan to adopt the alternative ("SIMPLE") method of satisfying the § 401(k) and § 401(m) nondiscrimination tests added by § 1422 of SBJPA.

2 As provided in § 417(e)(3)(B), the present value of a distribution from a pre-GATT plan that is made prior to the first plan year beginning after December 31, 1999, and before a plan amendment applying the GATT changes to § 417(e)(3) to the plan has been adopted and made effective generally must be determined under the plan's pre-GATT terms.

.08 Any amendment that would result in an elimination or reduction of § 411(d)(6) protected benefits may not be made retroactively effective unless specifically permitted by law or regulation or by revenue ruling, notice, or other guidance published in the Internal Revenue Bulletin.

.09 Section 1431(b)(1) of SBJPA eliminated the family aggregation requirements of § 414(q)(6), effective for years beginning after December 31, 1996. Section 1431(b)(2) of SBJPA also eliminated the family aggregation requirement that formerly applied under § 401(a)(17)(A), effective for years beginning after December 31, 1996. A plan's family aggregation provisions generally would be disqualifying provisions under § 401(b) because they would be integrally related to a qualification requirement of the Code that has been changed by SBJPA, effective before 1999. In certain limited circumstances, the continued application of the family aggregation rules in the operation of a plan could result in the loss of qualified status. The plan's family aggregation provisions also would then be disqualifying provisions because they would cause disqualification as a result of SBJPA changes to the qualification requirements effective before 1999. Regardless of whether a plan's family aggregation provisions are disqualifying provisions because they are integrally related to SBJPA qualification changes or because they would cause plan disqualification, a plan amendment eliminating the provisions will not violate the requirements of § 411(d)(6) provided the amendment is effective no earlier than the first day on which the plan was operated in accordance with the amendment, and in no event earlier than the first day of the first plan year beginning after December 31, 1996.

SECTION 7. TIME FOR ADOPTING CERTAIN AMENDMENTS RELATING TO SECTION 415

For purposes of § 767(d)(3)(B) of GATT, the date provided by the Secretary for adopting plan amendments reflecting the changes to § 415(b)(2)(E) is the last day of the plan's remedial amendment period under section 6.04. Moreover, as discussed in section 3.04, § 1449(d) of SBJPA provides that an amendment applying specified GATT changes that was adopted or effective before August 20, 1996, will be disregarded in applying § 767(d)(3)(A) of GATT, as modified by § 1449(a) of SBJPA, if that amendment is repealed by another plan amendment that is adopted no later than August 20, 1997. Pursuant to this revenue procedure, a plan amendment applying the amendments made by § 767 of GATT which was adopted or made effective on or before August 20, 1996, also shall not be taken into account in applying § 767(d)(3)(A) of GATT as amended by § 1449(a) of SBJPA, if the amendment is repealed by another plan amendment that is adopted on or before the last day of the plan's remedial amendment period under section 6.04. This relief will not fail to be available merely because a plan is not operated in accordance with the repealing amendment prior to the date specified in future guidance. The Service intends to issue additional guidance concerning the GATT and SBJPA changes to the limitations under § 415(b) in the near future.

SECTION 8. MINIMUM FUNDING REQUIREMENTS

Section 412 provides minimum funding standards applicable to pension plans that are or were qualified plans under § 401. Section 1.412(c)(3)–1 provides rules concerning the reasonable funding methods for defined benefit pension plans. Section 1.412(c)(3)–1(d)(1)(i) provides that, except as provided by the Commissioner, a reasonable funding method does not anticipate changes in plan benefits that become effective, whether or not retroactively, in a future plan year or that become effective during a plan year but after the first day thereof. Section 412(c)(12), which was added by GATT, provides that the funding method of a collectively bargained plan described in § 413(a) (other than a multiemployer plan) must anticipate benefit increases scheduled to take effect during the term of the collective bargaining agreement applicable to the plan. Therefore, except to the extent required by § 412(c)(12) or as otherwise provided by the Commissioner, in determining the minimum funding standards for a defined benefit plan under § 412, amendments that become effective, whether or not retroactively, in a future plan year may not be anticipated, even though the amendments are made before the end of any applicable remedial amendment period. Contributions to a defined benefit plan will be deductible subject to the limitations of § 404, with the § 412 minimum funding standards determined without anticipating such future amendments.

SECTION 9. TERMINATING PLANS

A plan (including a master or prototype, regional prototype, or volume submitter plan) that is terminated after the effective date of changes in the qualification requirements made by SBJPA or GATT but before the date that plan amendments would otherwise be required must be amended in connection with the plan termination to comply with the changes as of their effective date with respect to the plan. For this purpose, any amendment that is adopted after the date of plan termination in order to receive a favorable determination letter will be considered as adopted in connection with the plan termination. In addition, annuity contracts distributed from such terminated plans also must meet all the applicable requirements of SBJPA and GATT. In the case of changes in the qualification requirements to which § 1465 of SBJPA applies, the operational compliance requirement of § 1465 must also be satisfied. (See Notice 87–57, 1987–2 C.B. 368, and Announcement 88–8, 1988–4 I.R.B. 32,

which enunciated the same principles with respect to plans that terminated before the amendment date described in § 1140 of TRA '86.)

SECTION 10. PLANS WITH EXTENDED RELIANCE

As described above, the sponsor of a plan that is entitled to extended reliance on a favorable TRA '86 letter may rely on that letter until the earlier of the last day of the last plan year commencing prior to January 1, 1999, or the date established for plan amendment by any legislation that is effective after the date of the plan's letter. A plan with extended reliance must be amended by the last day of the first plan year beginning on or after January 1, 1999, to the extent necessary to comply with regulations or administrative guidance of general applicability that has been issued since the date of the plan's favorable TRA '86 letter. These amendments must be made effective no later than the first day of the first plan year beginning on or after January 1, 1999, and no earlier than the first day of the plan year in which the amendments are adopted. (But see Rev. Rul. 94–76, 1994–2 C.B. 46, and Rev. Rul. 96–48, 1996–40 I.R.B. 7.) Also see section 11, below, regarding preapproved plans.

SECTION 11. DETERMINATION AND OPINION LETTER PROGRAMS

.01 Effective with the date of enactment of SBJPA or GATT, as applicable, and until further notice is given, determination, opinion, notification, and advisory letters, other than determination letters issued for terminating plans, will not include consideration by the Service of any amendments to the qualification requirements made by SBJPA or GATT, with the following two exceptions. First, determination letters will include consideration of the changes made to § 401(a)(26) by § 1432 of SBJPA, which limited the applicability of § 401(a)(26) to defined benefit plans and made certain other changes. See Announcement 97–2, 1997–2, I.R.B. 62. Second, determinations of leased employee status under § 414(n) will reflect the "primary direction or control" test under § 414(n)(2)(C), as amended by § 1454 of SBJPA, that replaces the former "historically performed" test.

.02 Until further notice is given, plans (including master or prototype, regional prototype, and volume submitter plans), other than terminating plans, that include provisions that reflect the SBJPA or GATT amendments to the qualification requirements will not be subject to adverse letters by reason of the inclusion of the provisions. This will not preclude the issuance of adverse letters for other reasons, such as an impermissible elimination or reduction of § 411(d)(6) protected benefits resulting from the adoption of amendments for SBJPA or GATT. However, favorable letters issued for plans, other than terminating plans, may not be relied upon with respect to whether the plans satisfy the qualification requirements as amended by SBJPA or GATT.

.03 The Service will begin reviewing both preapproved plans and individually designed plans for compliance with the qualification requirements as amended by SBJPA and GATT as soon as possible after the issuance of additional guidance pertaining to the requirements of SBJPA. Prior to that time, the Service intends to publish procedures relating to the issuance of determination, opinion, notification and advisory letters for plans that take into account the requirements of SBJPA and GATT. The procedures are also expected to include rules pertaining to the required time for sponsors to amend preapproved plans for SBJPA and GATT and actions that may be required of adopters of these plans.

PART III. TIME FOR AMENDING SECTION 403(B) PLANS

SECTION 12. SECTION 403(B) PLANS

.01 SBJPA also made certain changes that may require the amendment of tax-sheltered annuity plans described in § 403(b) or annuity contracts purchased under these plans. The provisions of § 1465 of SBJPA apply with respect to any plan or annuity contract that is required to be amended by any provision of subtitle D of SBJPA. Section 1465 thus applies not only to qualified plans but also to § 403(b) plans and annuity contracts purchased under these plans. Therefore, if a provision of subtitle D of SBJPA requires an amendment to a § 403(b) plan or an annuity contract purchased under the plan, the amendment will not be required to be made before the time described in § 1465 of SBJPA, provided the retroactive amendment and operational compliance requirements of § 1465 are satisfied. For this purpose, the time described in § 1465 with respect to a § 403(b) plan that is a governmental plan will be treated as not expiring before the last day of the first plan year beginning on or after the 1999 legislative date, that is, the 90th day after the opening of the first legislative session beginning on or after January 1, 1999, of the governing body with authority to amend the plan, if that body does not meet continuously.

.02 For example, § 1450(c)(1) of SBJPA amended § 403(b)(1)(E) to provide that each contract purchased under a § 403(b) plan salary reduction agreement must provide that elective deferrals made under the contract may not exceed the annual limit on elective deferrals under § 402(g)(1). Prior to this amendment, the § 403(b) plan, not each contract, was required to provide this limitation. Section 1450(c)(2) provides that this amendment applies to years beginning after December 31, 1995, except a contract will not be required to meet any change in any requirement by reason of the amendment before the 90th day after enactment of SBJPA (that is, November 18, 1996). Because § 1465 applies to any annuity contract purchased under a § 403(b) plan, such a contract is not required to be amended to comply with § 1450(c)(1) before the first day of the first plan year beginning on or after January 1, 1998 (or, in the case of a contract purchased under a § 403(b) plan that is a governmental plan, the later of (i) the first day of the first plan year beginning on or after January 1, 2000, or (ii) the last day of the first plan year beginning on or after the 1999 legislative date), provided the retroactive amendment and operational compliance requirements of § 1465 are satisfied with respect to the contract.

SECTION 13. EFFECTIVE DATE

This revenue procedure is effective August 18, 1997.

DRAFTING INFORMATION

The principal author of this revenue procedure is James Flannery of the Employee Plans Division. For further information regarding this revenue procedure,

please contact the Employee Plans Division's taxpayer assistance telephone service between the hours of 1:30 p.m. and 4 p.m. Eastern Time, Monday through Thursday, by calling (202) 622-6074/6075, or Mr. Flannery on (202) 622-6214. (These telephone numbers are not toll-free numbers.)

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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 I, § 42; 1.42–14.)

Rev. Proc. 97–42

SECTION 1. PURPOSE

This revenue procedure publishes the amounts of unused housing credit carryovers allocated to qualified states under § 42(h)(3)(D) of the Internal Revenue Code for calendar year 1997.

SECTION 2. BACKGROUND

Rev. Proc. 92–31, 1992–1 C.B. 775, provides guidance to state housing credit agencies of qualified states on the procedure for requesting an allocation of unused housing credit carryovers under § 42(h)(3)(D). Section 4.06 of Rev. Proc. 92–31 provides that the Internal Revenue Service will publish in the Internal Revenue Bulletin the amount of unused housing credit carryovers allocated to qualified states for a calendar year from a national pool of unused credit authority (the National Pool). This revenue procedure publishes these amounts for calendar year 1997.

SECTION 3. PROCEDURE

The unused housing credit carryover amount allocated from the National Pool by the Secretary to each qualified state for calendar year 1997 is as follows:

Qualified State	*Amount Allocated*
Alabama	$ 77,659
Alaska	11,032
California	579,360
Colorado	69,480
Connecticut	59,503
Delaware	13,176
Florida	261,710
Georgia	133,636
Idaho	21,609
Illinois	215,311
Indiana	106,156
Iowa	51,833
Kansas	46,744
Maryland	92,180
Massachusetts	110,718
Michigan	174,364
Minnesota	84,656
Mississippi	49,361
Missouri	97,396
Nebraska	30,024
Nevada	29,133
New Hampshire	21,119
New Jersey	145,176
New York	330,500
North Carolina	133,090
Ohio	203,061
Oregon	58,230
Pennsylvania	219,109
Rhode Island	17,993
South Carolina	67,227
South Dakota	13,304
Texas	347,638
Utah	36,349
Vermont	10,705
Virginia	121,313
Washington	100,558

SECTION 4. EFFECTIVE DATE

This revenue procedure is effective for allocations of housing credit dollar amounts attributable to the National Pool component of a qualified state's housing credit ceiling for calendar year 1997.

DRAFTING INFORMATION

The principal author of this revenue procedure is Christopher J. Wilson of the Office of Assistant Chief Counsel (Passthroughs and Special Industries). For further information regarding this revenue procedure, contact Mr. Wilson on (202) 622-3040 (not a toll-free call).

Part IV. Items of General Interest

Changes in Employer Reporting of Moving Expense Reimbursements—Elimination of Form 4782 and Changes to Form W–2 Reporting

Announcement 97–77

Purpose

This announces that the Internal Revenue Service will eliminate Form 4782, Employee Moving Expense Information, effective for tax year 1998. Also included are changes to the reporting of moving expense reimbursements by employers to employees on Form W–2. These changes are effective for 1998 Forms W–2 that employees will receive in 1999.

Background

Form 4782 is used by employers to report moving expense reimbursements made to employees. P.L. 103–66 modified IRC Section 132 to exclude from an employee's gross income employer reimbursements for qualified moving expenses. After that change in law, some employers still found Form 4782 to be helpful to employees in understanding the amounts that appear on their Forms W–2. However, many employers also told us that Form 4782 was no longer needed, was burdensome to file, and that it should be eliminated.

As a result of input received from the employer community, the Service has decided to eliminate Form 4782. However, employers may continue providing similar information to employees in any format they wish if they deem it helpful to employees.

Form W–2 Reporting

With the elimination of Form 4782, the IRS is further simplifying the reporting of qualified moving expenses on Form W–2. The IRS instructions for employers preparing Forms W–2 for tax year 1998 will reflect that:

- Qualified moving expenses an employer pays **to a third party on behalf of the employee** (e.g., to a moving company) and services that an employer furnishes in kind to an employee will not be reported at all on Form W–2.
- Qualified moving expenses reimbursements an employer pays **directly to an employee** will be reported in Box 13 of Form W–2 and will be identified using Code P. (Currently, ***all*** qualified moving expense reimbursements are identified with Code P, regardless of whether or not they were paid directly to the employee.)
- Other moving expense reimbursements (so-called nonqualified expenses), whether or not paid directly to a third party, will continue to be included in wages (Form W–2, box 1) and are subject to income tax withholding and social security and Medicare taxes.

Employee Reporting on Form 3903

As a result of the simplification of employer reporting, the deduction for qualified moving expenses by employees will also be simplified. Beginning with 1998 returns filed in 1999, employees will report on **Form 3903,** Moving Expenses, only the qualified moving expenses paid directly by them. On Form 3903, employees will reduce these expenses by the amounts reimbursed by their employers and reported in box 13 of Form W–2.

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 Contribution 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.—Internal 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 Procedral 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 1997–1 through 1997–26 will be found in Internal Revenue Bulletin 1997–27, dated July 7, 1997.

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[1] A cumulative finding list for previously published items mentioned in Internal Revenue Bulletins 1997–1 through 1997–26 will be found in Internal Revenue Bulletin 1997–27, dated July 7, 1997.

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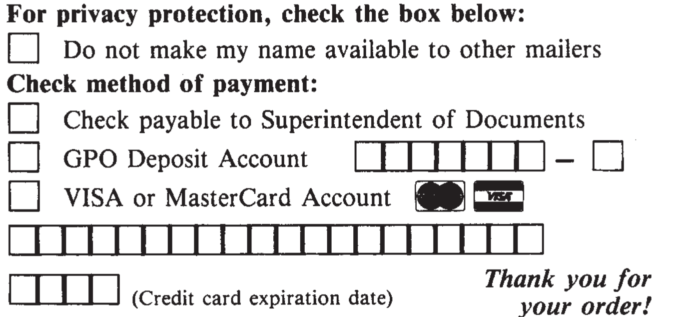

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