

Part III - Administrative, Procedural, and Miscellaneous

Proposed Changes to the Process for Obtaining the Commissioner's Consent to Change a Method of Accounting

Notice 2007-88

PURPOSE

This notice requests comments from the public regarding a proposal to change the process by which taxpayers obtain the consent of the Commissioner of Internal Revenue to change a method of accounting for federal income tax purposes. The proposal described in this notice is one possible approach. The Internal Revenue Service (IRS) is interested in considering other possible approaches. Therefore, changes to the process, including any pilot program, will not become effective until the IRS considers public comments and suggestions received in response to this notice and publishes guidance announcing changes to the process.

BACKGROUND

A. The Existing Accounting Method Change Process

Section 446(e) of the Internal Revenue Code requires taxpayers to obtain the consent of the Commissioner before changing a method of accounting for federal income tax purposes. A change in a 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 item that involves the proper time for the inclusion of the item in income or the taking of the item as a deduction. Taxpayers request the Commissioner's consent to change a method of accounting by filing a Form 3115, *Application for Change in Accounting Method*, that describes the current and new methods of accounting, identifies items that will be treated differently under the new method of accounting, and includes a computation of any adjustment required by section 481(a).

The Commissioner has issued administrative procedures instructing taxpayers how and when to file Form 3115, and prescribing the terms and conditions necessary to obtain consent to change an accounting method. These procedures are contained principally in Rev. Proc. 2002-9, 2002-1 C.B. 327, as modified and clarified by Announcement 2002-17, 2002-1 C.B. 561, modified and amplified by Rev. Proc. 2002-19, 2002-1 C.B. 696, and amplified, clarified and modified by Rev. Proc. 2002-54, 2002-2 C.B. 432 ("automatic consent process") and Rev. Proc. 97-27, 1997-1 C.B. 680, as modified and amplified by Rev. Proc. 2002-19, as amplified and clarified by Rev. Proc. 2002-54 ("nonautomatic consent process").

1. The automatic consent process

Under the existing process, the Commissioner grants eligible taxpayers automatic consent to change to certain methods of accounting, most of which are described in the Appendix to Rev. Proc. 2002-9. A taxpayer that seeks to change to one of these methods must attach Form 3115 to its timely filed (including extensions) original income tax return for the requested year of change and send a copy of the Form 3115 to the IRS national office no later than the date that the original Form 3115 is filed

with the federal income tax return for the year of change. In general, a taxpayer, not under audit, complying with all the applicable provisions of Rev. Proc. 2002-9 has obtained the consent of the Commissioner to change its method of accounting and ordinarily receives both “audit protection” and “ruling protection.” That is, the IRS 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 (“audit protection”). The IRS also will not require the taxpayer to change or modify the new method of accounting except in certain circumstances specifically enumerated in section 8 of Rev. Proc. 2002-9 and, if the IRS does require the taxpayer to change or modify the new method of accounting, the required change or modification to the new method of accounting generally will not be applied retroactively (“ruling protection”). In other words, the taxpayer receives protection with respect to the use of the new method of accounting in future years.

Rev. Proc. 2002-9 is the exclusive procedure for a taxpayer within the scope of Rev. Proc. 2002-9 to obtain the consent of the Commissioner before changing a method of accounting. Accordingly, a taxpayer that qualifies to make a change through the automatic consent process may not opt to make the change under the nonautomatic consent process described below. A user fee is not charged in the automatic consent process.

The IRS national office reviews Forms 3115 filed through the automatic consent process to determine whether the form is properly completed and whether the taxpayer qualifies for automatic consent. If the IRS national office reviews a Form 3115 and determines that the form is not properly completed, or if supplemental information is

needed, the IRS national office notifies the taxpayer, specifies the information that is needed, and permits the taxpayer 30 days to furnish the necessary information. If the IRS national office tentatively determines that the taxpayer has changed its method of accounting without complying with all the applicable provisions of Rev. Proc. 2002-9, the IRS national office notifies the taxpayer of its tentative adverse determination and offers the taxpayer a conference of right, if the taxpayer has requested such a conference. In cases where the IRS national office remains adverse after the conference of right, it notifies the taxpayer that consent to make the change in method of accounting is not granted.

2. The nonautomatic consent process

Changes that do not qualify for automatic consent must be requested under the nonautomatic consent process described in Rev. Proc. 97-27. A taxpayer that seeks the Commissioner's consent to change a method of accounting through the nonautomatic consent process must file Form 3115 with the IRS national office during the taxable year in which the taxpayer desires to make the proposed change. There is a user fee for a nonautomatic consent request (in general, the current fee is \$2,500 per request).

In processing a request for a change in method of accounting made through the nonautomatic consent process, the IRS national office considers, among other factors, whether the requested method of accounting is legally permissible for the taxpayer, whether the requested method clearly reflects the taxpayer's income, and whether the taxpayer has appropriately computed any adjustment required by section 481(a). The

processing of a taxpayer's request for an accounting method change may involve requests for supplemental information from the taxpayer, including requests for additional facts and clarification of how the taxpayer intends to apply the requested method to particular types of transactions. If supplemental information is needed, the IRS national office notifies the taxpayer and the taxpayer generally is permitted 21 days to furnish the necessary information.

If the taxpayer's requested accounting method change is approved by the IRS national office, the taxpayer receives a letter ruling granting the taxpayer consent to make the change subject to certain terms and conditions. The taxpayer also generally receives audit protection and ruling protection. In cases where the IRS national office is tentatively adverse to the taxpayer's requested change in method of accounting, the IRS national office notifies the taxpayer of its tentative adverse determination and offers the taxpayer a conference of right, if the taxpayer has requested such a conference. If the IRS national office remains adverse after the conference of right, it notifies the taxpayer that consent to make the change in method of accounting is denied.

B. Reasons for Change

The IRS is concerned that certain aspects of the existing accounting method change process make it a complex and inefficient means for taxpayers to obtain consent to change an accounting method. These complexities and inefficiencies often result in significant delays in the processing of accounting method change requests. The IRS believes that an efficient process that provides taxpayers with a means of obtaining timely consent to change to a proper method of accounting is crucial to

ensuring that taxpayers comply with the consent requirement of section 446(e).

Accordingly, the IRS is considering proposals to modify the accounting method change process. In considering any modifications to the existing process, the IRS will balance taxpayers' need for timely consent with the Commissioner's responsibility to ensure that the process comports with the purpose underlying section 446(e).

Prior to the codification of sections 446(e) and 481 in 1954, the regulations imposed a "consent" requirement on taxpayers seeking a change in accounting method, the purpose of which was to give the Commissioner the opportunity to insist on compensating adjustments to eliminate the omissions and duplications of income and deductions that can result from a change in accounting method. Today, section 481(a) provides for such adjustments, thereby diminishing the role of the consent requirement as a means for the Commissioner to mandate these adjustments. The consent requirement is recognized today as serving broader policy aims, such as promoting consistent accounting practices and easing the administrative burden on the Commissioner of detecting accounting method changes.

The IRS believes that the proposal contained in this notice fulfills the broad policy aims of section 446(e). As under the existing automatic consent and nonautomatic consent processes, the IRS intends to review all accounting method change requests, and to focus on those that raise novel or controversial accounting method change issues. The IRS expects that the proposal contained in this notice will simplify the consent process and reduce delays for most taxpayers, while preserving the ability of the IRS to effectively monitor changes of accounting methods.

PROPOSAL

The IRS is considering whether to modify the accounting method change process so that the existing “automatic consent” process and “nonautomatic consent” process are replaced with a system under which a taxpayer requests “standard consent,” “specific consent” or “letter ruling consent.”

A. Standard Consent Process

1. In general

The IRS anticipates that, under this proposal, the majority of accounting method change requests would be made through the standard consent process. The proposed standard consent process is expected to operate in a manner similar to the existing automatic consent process – a taxpayer that timely files Form 3115 with its tax return and complies with the procedures governing the process is granted the Commissioner’s consent to change its method of accounting. A change made under the standard consent process must be made under the published terms and conditions applicable to the standard consent process. No letter ruling would be issued by the IRS, and no user fee would be charged.

All changes in method of accounting that are specifically identified in Rev. Proc. 2002-9 (or any successor), or other automatic consent guidance, would be eligible for consent under the standard consent process. As is the case under the existing automatic consent process, taxpayers changing to one of these specifically identified methods of accounting would ordinarily obtain audit protection and ruling protection. The IRS anticipates that Rev. Proc. 2002-9 (or any successor), and other automatic

consent guidance, would be incorporated into the administrative procedures that govern the standard consent process. Consequently, the standard consent process would be the exclusive process available to taxpayers changing to methods of accounting specifically identified in Rev. Proc. 2002-9 (or any successor) and other automatic consent guidance.

This proposal contemplates that the standard consent process would be available even for changes that are not identified in Rev. Proc. 2002-9 (or any successor), or other automatic consent guidance. That is, except for changes required to be made under the proposed specific consent process (described below), a taxpayer that timely files Form 3115 with its tax return and complies with the procedures governing the standard consent process would have the Commissioner's consent to change to any permissible method of accounting for the requested year of change, including changes to methods of accounting not specifically identified in Rev. Proc. 2002-9 (or any successor) or other automatic consent guidance. However, unlike the consent applicable to method changes specifically identified in Rev. Proc. 2002-9 (or any successor), or other automatic consent guidance, a taxpayer's change of its method of accounting to a method other than a method specifically identified in Rev. Proc. 2002-9 (or any successor), or other automatic consent guidance, would receive only audit protection for years prior to the requested year of change and would not receive ruling protection.

Although the proposal contemplates that taxpayers would file Form 3115 with their returns for the requested year of change, the IRS is considering an alternative

approach under which taxpayers would be required to file Form 3115 for changes to methods of accounting not specifically identified in Rev. Proc. 2002-9 (or any successor) or other automatic guidance, by the last day of the ninth month of the requested taxable year of change. Requiring Form 3115 to be filed during the requested taxable year of change, rather than with the tax return for the requested taxable year of change, would provide the IRS with time to consider the request before the taxpayer files its return for the requested taxable year of change. The IRS requests comments on this alternative approach.

The IRS expects that the standard consent process would give taxpayers who seek consent under section 446(e) without ruling protection the opportunity to obtain this consent in a timely and efficient manner. The taxpayer's filing of Form 3115 would give the IRS adequate notice of the change in accounting method. Further, the lack of ruling protection for changes that are not specified in Rev. Proc. 2002-9 (or any successor), or other automatic consent guidance, puts the taxpayer in no worse a position with regard to the new method of accounting as the taxpayer is in with regard to other items of income or deduction reported on the return. That is, the taxpayer's use of the new method of accounting is an issue that may be considered upon examination.

2. IRS review of Forms 3115

Under the proposal, the IRS would screen accounting method change requests for completeness and for compliance with the procedures governing the standard consent process. Requests that are not substantially complete would be denied consent and the taxpayer would be notified that consent is not granted. In contrast to

the procedures contained in section 10.02 of Rev. Proc. 2002-9, under the proposal, the IRS does not intend to permit taxpayers to perfect requests that are not substantially complete prior to denying consent. As a consequence, a taxpayer who submits a form that is not substantially complete would not receive consent to change its method of accounting in the proposed year of change and, thus, would not receive ruling protection or audit protection. The IRS plans to issue guidelines and examples of what constitutes a substantially complete Form 3115. For example, a Form 3115 must include sufficient information about the current and new methods of accounting to permit the IRS to understand how the methods work, and must identify legal authority (including any contrary authority) governing the new method of accounting. However, minor omissions or errors on Form 3115 would not result in the denial of consent.

In addition to screening accounting method change requests for completeness, the IRS would review Forms 3115 filed under the standard consent process to determine whether the new accounting method is permissible. In cases where the IRS agrees that the new method is permissible, ordinarily no further action would be taken and the taxpayer would not be advised that the review has taken place. In cases where the IRS questions the propriety of the new method, the IRS may correspond with the taxpayer to resolve the matter. In some cases, resolution may require the taxpayer to provide additional information about the change. If the IRS tentatively determines that the new method of accounting is impermissible, the IRS would notify the taxpayer of the tentative adverse determination and will ordinarily offer the taxpayer a conference. In cases where the IRS remains adverse after the conference, it would notify the taxpayer

that consent to make the change in method of accounting is not granted.

Under the existing accounting method change process, the IRS provides audit protection for changes in method of accounting only if the request for change is granted.

The IRS is considering whether it would be appropriate to provide audit protection even in cases where consent is not granted. Providing audit protection in such cases may encourage taxpayers to seek consent to change from improper methods of accounting.

B. Specific Consent Process

The specific consent process is proposed to be available for only two categories of accounting method changes: (1) accounting method changes specifically identified in published guidance as required to be made under the specific consent process, and (2) changes that otherwise qualify under the standard consent process, but for which the taxpayer seeks different terms and conditions or a waiver of certain scope limitations that apply to the standard consent process. Each of these categories is discussed in further detail below. The IRS expects that under this proposal a user fee would apply to a change requiring specific consent.

1. Changes identified in published guidance

Under the proposal, the IRS would publish guidance in the Internal Revenue Bulletin that lists specific accounting method changes that must be made using the specific consent process. The specific accounting method changes listed in this published guidance would include the types of changes that the IRS wants to review in more depth and prior to the taxpayer implementing the accounting method on its tax return. The IRS would update the proposed published list as necessary to add or

remove specific accounting method changes that are required to be made under the specific consent process. The IRS expects that, in general, the process for requesting specific consent would be similar to the existing advance consent process described in Rev. Proc. 97-27. That is, a taxpayer files a Form 3115 that is substantially complete (as discussed above in the description of the standard consent process) and awaits a ruling from the IRS granting consent to the change. To give the IRS adequate time to consider the request prior to the due date of the taxpayer's tax return for the requested taxable year of change, the IRS expects to require taxpayers to file Form 3115 by the last day of the ninth month of the requested taxable year of change, without the possibility of relief for late requests under section 301.9100 of the Regulations on Procedure and Administration. However, the IRS intends to consider an otherwise qualified request filed after the last day of the ninth month of a taxable year and before the beginning of the succeeding taxable year a timely filed request for the succeeding taxable year.

If a taxpayer's consent request is granted, audit protection would apply and ruling protection would usually apply. However, the IRS, in its discretion, may decline to grant ruling protection in a particular case.

2. Changes seeking modified terms and conditions or a waiver of certain scope limitations

The specific consent process would also apply to any change that otherwise qualifies for the standard consent process (including a change specifically identified in Rev. Proc. 2002-9, or any successor, or other automatic consent guidance), but for the

fact that the taxpayer seeks a term and condition different from those that apply to standard consent requests, or seeks a waiver of certain scope limitations that apply to standard consent requests. For example, a taxpayer that filed a Form 3115 under the standard consent process and seeks to make a subsequent change to the same item within five years would be required to request consent under this specific consent process to make the subsequent change. As provided in section 8.02 of Rev. Proc. 97-27, the IRS may determine that, based on the unique facts of a particular case and in the interest of sound tax administration, terms and conditions that differ from those that ordinarily apply are more appropriate for a particular accounting method change. It is not intended that under this proposal the IRS would change its policy concerning the circumstances in which it will approve a request for modified terms and conditions. Taxpayers should be aware that it is only in rare situations that the IRS agrees to a taxpayer's request for terms and conditions different from those prescribed in published guidance.

To give the IRS adequate time to consider the request prior to the due date of the taxpayer's tax return for the requested taxable year of change, the IRS expects to require taxpayers to file Form 3115 by the last day of the ninth month of the requested taxable year of change, without the possibility of relief for late requests under section 301.9100 of the Regulations on Procedure and Administration. However, the IRS intends to consider an otherwise qualified request filed after the last day of the ninth month of a taxable year and before the beginning of the succeeding taxable year a timely filed request for the succeeding taxable year.

Under the proposal, in cases where the IRS agrees to the modified term and condition or the waiver of certain scope limitations, any consent would be granted under the standard consent process, generally with audit protection and without ruling protection. That is, no ruling letter would be issued; the IRS would simply issue a waiver that permits the taxpayer to utilize the standard consent process to make the change with the modified term and condition or with a waiver of the scope limitation. In appropriate cases, the IRS would limit audit protection where the taxpayer previously received audit protection for the same item under the standard consent process.

C. Letter Ruling Consent Process

The IRS recognizes that some taxpayers who seek to change an accounting method may want the certainty of a letter ruling issued by the IRS national office concerning the propriety of a requested method of accounting. Under the proposal, a taxpayer that seeks a change in accounting method other than a change that is specifically identified in Rev. Proc. 2002-9 (or any successor), or other automatic consent guidance, may request a letter ruling under Rev. Proc. 2007-1, 2007-1 I.R.B. 1, (or its successor). The IRS would apply Rev. Proc. 2007-1 (or its successor) and Rev. Proc. 2007-3, 2007-1 I.R.B. 108, (or its successor) in determining whether to rule on a request filed under the letter ruling consent process.

The IRS is concerned that requests for accounting method changes made under the existing advance consent process often are not as well developed as requests for letter rulings generally. Under this proposal, a taxpayer utilizing the letter ruling consent process must submit a fully developed request, and that request would be subject to the

same standard of factual and legal development as a request for a letter ruling generally. Under this proposal, a letter ruling request would include, among other information, a complete statement of facts, copies of documents pertinent to the transaction, statements of supporting and contrary authorities, examples of the application of the new method to the taxpayer's transaction and a completed Form 3115 as an attachment to the letter ruling request. As provided in Rev. Proc. 2007-1, taxpayers must provide any additional information requested by the IRS and, if a taxpayer does not submit the information within 21 calendar days from the date of the request, the letter ruling request would be closed and the taxpayer would be notified in writing.

Requests made under this letter ruling consent process would be subject to the generally applicable user fee imposed on letter ruling requests, and not the user fee currently imposed in the existing advance consent process. Further, the IRS intends to require taxpayers to submit letter ruling consent requests by the last day of the ninth month of the requested taxable year of change, without the possibility of relief for late requests under section 301.9100 of the Regulations on Procedure and Administration. However, the IRS intends to consider an otherwise qualified letter ruling request filed after the last day of the ninth month of a taxable year and before the beginning of the succeeding taxable year a timely filed letter ruling request for the succeeding taxable year.

If the IRS national office rules favorably on the letter ruling request, it also would grant the taxpayer consent under section 446(e) to change its method of accounting for

the item that is the subject of the letter ruling request. Audit protection and ruling protection would apply.

D. Pilot Program

The IRS intends to implement any changes to the accounting method change process on a pilot basis before making permanent changes to the process. The IRS expects to open the pilot program to all taxpayers making an accounting method change within a specified pilot period. During the pilot period, the IRS will continue to evaluate the process. The IRS emphasizes that this notice does not establish a pilot program. The IRS will consider public comments received in response to this notice before establishing a pilot program in separate guidance. In the meantime, taxpayers must continue to follow the existing procedures (e.g., Rev. Proc. 97-27 and Rev. Proc. 2002-9) for obtaining consent to change an accounting method.

REQUEST FOR COMMENTS

The proposal contained in this notice is one way, but not the only way, that the accounting method change process could be modified to improve efficiencies and reduce delays both for taxpayers and the IRS. The IRS requests public comments on this proposal and any other suggestions for modifying and improving the accounting method change process. Any modification to the accounting method change process will not become effective until the IRS considers any public comments received and publishes additional guidance announcing changes to the process.

Written submissions in response to this notice should be submitted no later than January 18, 2008 to Internal Revenue Service, CC:PA:LPD:RU (Notice 2007-88), room

5203, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:RU (Notice 2007-88), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue NW, Washington, DC 20224. Alternatively, submissions may be submitted via the Internet at Notice.Comments@irsounsel.treas.gov in which case "Notice 2007-88" should be in the subject line. All submissions will be available for public inspection and copying in their entirety. Therefore, submissions received by the IRS should not include taxpayer-specific information of a confidential nature. Submissions should include the name and telephone number of a person to contact.

DRAFTING INFORMATION

The principal authors of this notice are Andrew J. Keyso and Brenda D. Wilson of the Office of Associate Chief Counsel (Income Tax & Accounting). For further information regarding this notice contact Mr. Keyso or Ms. Wilson at (202) 622-4800 (not a toll-free call).