

Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

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November 24, 1999

LEGEND:

P =

S =

Y =

Z =

Year 1 =

Year 2 =

Product =

This is in response to a request for a private letter ruling submitted by your authorized representative for the consent of the Commissioner, under § 446(e) of the Internal Revenue Code and § 1.446-1(e) of the Income Tax Regulations, to change a method of accounting. You have been reporting certain intercompany transactions on a separate entity or current year basis since Year 1, without having secured the consent of the Internal Revenue Service (the "Service") as required by § 1.1502-13(e)(3) and § 1.1502-13(c)(3) of the 1966 regulations. Permission is hereby requested to comply with the reporting provisions of § 1.1502-13 to report all intercompany transactions on a single entity basis beginning with the Year 2 tax year (hereinafter "the proposed method").

The information submitted indicates that P is the common parent of a consolidated group (the "P Group"). The P Group consists of P, S, Y and Z (sometimes referred to hereinafter as "taxpayer"). P is a wholesaler of Product. S is engaged in the retail sale of Product to individual consumers outside the Group. P sells Product to S in

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the ordinary course of business. These sales constitute intercompany transactions and are among the intercompany transactions that occur between Group members.

In order to clearly reflect the taxable income of the group as a whole, § 1.1502-13 sets forth rules generally requiring that intercompany transactions be treated in a manner that produces the effect of transactions between divisions of a single corporation ("single entity treatment"). Section 1.1502-13(a)(3) provides that the timing rules of § 1.1502-13 are a method of accounting for intercompany transactions, to be applied by each member in addition to the member's other methods of accounting.

Section 1.1502-13(e)(3) of the current regulations (and § 1.1502-13(c)(3) of the 1966 regulations) provides an exception to the general rule of deferral in that the common parent may request the Service's consent to take into account on a separate entity basis items from intercompany transactions other than intercompany transactions with respect to stock or obligations of members.

Rev. Proc. 97-49, 1997-2 C.B. 523, provides the procedure by which taxpayers may (1) obtain the consent of the Service to treat some or all intercompany transactions on a separate entity basis under § 1.1502-13(e)(3), (2) revoke such consent, or have such consent revoked by the Service, and (3) obtain the Service's consent to change from separate entity reporting to single entity reporting where a valid consent from the Service to report intercompany transactions on a separate entity basis was not previously obtained. Any such changes in methods of accounting are effected on a cut-off basis (i.e., no § 481(a) adjustment).

Further, § 9 of Rev. Proc. 97-49 provides that the Service's consent under § 446(e) to change from separate entity reporting to single entity reporting must be requested under separate applicable administrative procedures in cases where a valid consent from the Service to report intercompany transactions on a separate entity basis was not previously obtained (as in the instant case).

Section 446(e) and § 1.446-1(e) require a taxpayer to obtain the advance consent of the Commissioner before changing its method of accounting. Section 1.446-1(e)(2)(ii)(a) provides that a change in method of accounting includes a change in the overall plan of accounting for gross income or deductions or a change in the treatment of any material item used in such overall plan. A material item is any item which involves the proper time for the inclusion of the item in income or the taking of a deduction. Section 1.446-1(e)(2)(ii)(c) provides that a change in an overall plan or system of identifying or valuing items in inventory is a change in method of accounting. Also, a change in the treatment of any material item used in the overall plan for identifying or valuing items in inventory is a change in method of accounting.

Section 1.1502-17(b) provides that if a member of a group changes its method of accounting for a consolidated return year, the terms and conditions prescribed by the

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Commissioner under § 446(e), including § 481(a) where applicable, shall apply to the member. It further provides that if a member changes its method of accounting for intercompany transactions for a consolidated return year, the change in method generally will be effected on a cut-off basis.

Rev. Proc. 97-27, 1997-1 C.B. 680, provides the general procedures under § 446(e) and § 1.446-1(e) for obtaining the Commissioner's consent to change a method of accounting. Section 2.06 of Rev. Proc. 97-27 provides that 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 are accounted for under the new method of accounting. Any items arising before the year of change continue to be accounted for under the taxpayer's former method of accounting.

In the instant case, P has been taking into account gain on the sale of Product in the year of the intercompany transaction (sale) to S. Thus, Group members have been determining and reporting items on a separate entity basis. Group members did not previously receive consent from the Service pursuant to § 1.1502-13(e)(3) or prior § 1.1502-13(c)(3) to report intercompany transactions on a separate entity basis.

Under the proposed method, Group members will treat items of income, gain, deduction and loss from intercompany transactions in accordance with § 1.1502-13. Specifically, P will defer taking into account its gain from intercompany transaction Product sales to S until such time as the items are required to be taken into account under § 1.1502-13. Accordingly, this change will constitute a change in method of accounting for purposes of § 1.446-1(e)(2)(ii)(a) because the proper time for the inclusion of an item in income or the taking of a deduction is involved.

Based solely on the information submitted and representations made, consent of the Service is hereby granted under § 446(e) and § 1.446-1(e) for each member of the P Group to utilize the proposed method by applying the rules of § 1.1502-13 for the Year 2 tax year and all subsequent consolidated return years. Pursuant to § 1.1502-17(b), § 2.06 of Rev. Proc. 97-27, and § 9 of Rev. Proc. 97-49, the change in method of accounting is to be effected on a cut-off basis for transactions entered into on or after the first day of Year 2 (i.e., no § 481(a) adjustment).

No opinion is expressed as to the tax treatment of the transactions under other provisions of the Code and regulations, or about the tax treatment of any conditions existing at the time of, or effects resulting from, the transactions that are not specifically covered by the above rulings.

A copy of this letter should be attached to the federal income tax returns of the corporations involved for the first tax year covered by this ruling letter.

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This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

In accordance with a power of attorney on file with this office, a copy of this ruling letter is being sent to the taxpayer's authorized representative.

Sincerely,

By: Assistant Chief Counsel (Corporate)
Edward S. Cohen
Chief, Branch 2