

Part III

Administrative, Procedural and Miscellaneous

26 CFR 601.204: Changes in accounting periods and in methods of accounting.
(Also Part I, §§ 446, 448, 481)

Rev. Proc. 2006-56

SECTION 1. PURPOSE

This revenue procedure provides the exclusive procedures under which a taxpayer may request the consent of the Commissioner to make certain changes to, from, or within a nonaccrual-experience (NAE) method of accounting and to adopt certain NAE methods.

SECTION 2. BACKGROUND

.01 Section 448(d)(5) of the Internal Revenue Code provides a special NAE method of accounting with respect to amounts to be received by certain taxpayers for the performance of services.

.02 The NAE method is available only to a taxpayer using an accrual method of accounting that either provides services in a field described in § 448(d)(2)(A) (health, law, engineering, architecture, accounting, actuarial science, performing arts, or consulting), or that meets the \$5 million annual gross receipts test of § 448(c). The taxpayer may not charge interest or penalties for failure to timely pay the amount

charged for the performance of services.

.03 On September 6, 2006, the Internal Revenue Service and Treasury Department published final regulations under § 1.448-2 of the Income Tax Regulations (TD 9285, 71 FR 52430, 2006-41 I.R.B. 656). The final regulations apply to taxable years ending on or after August 31, 2006. The preamble to the final regulations states that the Service and Treasury Department intend to issue administrative guidance providing procedures for changes in a NAE method of accounting and to adopt certain NAE methods of accounting.

.04 Sections 446(e) and 1.446-1(e)(2) state that, except as otherwise provided, a taxpayer must secure the consent of the Commissioner before changing a method of accounting for federal income tax purposes. Section 1.446-1(e)(3)(ii) authorizes the Commissioner to prescribe administrative procedures setting forth the limitations, terms, and conditions necessary to permit a taxpayer to obtain consent to change a method of accounting in accordance with § 446(e).

.05 Section 1.446-1(e)(1) states that a taxpayer filing its first return may adopt any permissible method of accounting and that a taxpayer may adopt any permissible method in connection with each separate and distinct trade or business, the income from which is reported for the first time.

.06 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) provides procedures for a taxpayer to obtain automatic consent of the Commissioner to change to a method of accounting described in the Appendix of Rev.

Proc. 2002-9.

.07 Rev. Proc. 97-27, 1997-1 C.B. 680 (as modified and amplified by Rev. Proc. 2002-19, 2002-1 C.B. 696, and amplified and clarified by Rev. Proc. 2002-54, 2002-2 C.B. 432), provides procedures for a taxpayer to obtain advance consent of the Commissioner to change its method of accounting.

.08 Section 481(a) requires the adjustments necessary to prevent amounts from being duplicated or omitted when a taxpayer's taxable income is determined under a method of accounting different from the method used to determine taxable income for the preceding taxable year.

SECTION 3. SCOPE

.01 This revenue procedure applies to a taxpayer that wants to make one or more of the following changes or adoptions:

(1) Change to a safe harbor NAE method provided in § 1.448-2(f)(1) (the revenue-based moving average method), (f)(2) (the actual experience method), (f)(3) (the modified Black Motor method), (f)(4) (the modified moving average method), or (f)(5) (the alternative nonaccrual-experience method);

(2) Change to a periodic system (for further guidance, see, for example, Notice 88-51, 1988-1 C.B. 535);

(3) Change from a NAE method to a specific charge-off method;

(4) Change from a sub-method of its current NAE method provided in § 1.448-2 regarding applicable periods to another sub-method regarding applicable periods that is permitted under § 1.448-2, other than a change to exclude taxable years from an applicable period under § 1.448-2(d)(6);

(5) Change from a sub-method of its current NAE method provided in § 1.448-2 regarding tracing of recoveries to another sub-method regarding tracing of recoveries permitted under § 1.448-2(f)(2)(iii);

(6) Change a sub-method unrelated to the applicable period or to the tracing of recoveries for a taxpayer currently using a NAE method provided in § 1.448-2(f);

(7) Change to a NAE method other than a safe harbor method provided in § 1.448-2(f)(1) through (5); or

(8) Adopt a NAE method other than a safe harbor method provided in § 1.448-2(f)(1) through (5).

.02 This revenue procedure does not apply to a taxpayer that seeks to adopt one of the safe harbor NAE methods provided in § 1.448-2(f)(1) through (f)(5). A taxpayer that seeks to adopt a safe harbor NAE method provided in § 1.448-2(f)(1) through (5) must follow the general rules for adoption of a method of accounting in § 1.446-1(e)(1). Generally, a taxpayer is not required to request advance consent or file a Form 3115, Application for Change in Method of Accounting, to adopt a method of accounting for the first time.

SECTION 4. APPLICATION

.01 Automatic change in method of accounting.

(1) In general. A taxpayer seeking to make a change within the scope of section 3.01(1) through (5) of this revenue procedure, in accordance with section 6.01 of Rev. Proc. 2002-9, is granted the consent of the Commissioner to change to a method of accounting provided in the final regulations, to a periodic system, or to a

specific charge-off method, as applicable, provided that the taxpayer follows the automatic change in method of accounting provisions in Rev. Proc. 2002-9, or its successor, subject to the following modifications:

(a) The scope limitations in section 4.02 of Rev. Proc. 2002-9 do not apply for the taxpayer's first taxable year ending on or after August 31, 2006. However, if the taxpayer's NAE method of accounting is an issue under consideration for taxable years under examination, before an appeals office, or before a federal court, at the time the Form 3115 is filed with the national office, the audit protection of section 7 of Rev. Proc. 2002-9 does not apply. A taxpayer's NAE method of accounting 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, or notification of proposed adjustments or income tax examination changes) from the examining agent(s) specifically citing the treatment of the NAE method of accounting as an issue under consideration.

(b) The designated automatic accounting method change number for changes in method of accounting made pursuant to this revenue procedure is No. 35; and

(c) A change in method of accounting within section 3.01(1), (2), (3), or (5) of this revenue procedure results in a § 481(a) adjustment. A change in method of accounting within section 3.01(4) of this revenue procedure is made on a cut-off basis.

(2) Concurrent change to overall accrual method and a NAE method of accounting.

(a) First § 448 year. A taxpayer that is within the scope of section 3.01(1) through (5) of this revenue procedure that wants to change to a NAE method of accounting (with or without also changing to a periodic system) and is required to change to an overall accrual method of accounting under § 448 and the regulations thereunder must request to make both changes by filing one Form 3115, and the taxpayer must follow the change in method of accounting provisions of § 1.448-1(h)(2). The taxpayer must complete all applicable sections of Form 3115, including sections that apply to the change to an overall accrual method and to the change to the NAE method, and must enter the automatic accounting method change numbers for both changes on Form 3115.

(b) Other automatic consent changes to overall accrual method. A taxpayer that is within the scope of section 3.01(1) through (5) of this revenue procedure that wants to change to a NAE method of accounting (with or without also changing to a periodic system) and is eligible to change to an overall accrual method of accounting under Appendix section 5.01 of Rev. Proc. 2002-9, or its successor, must request to make both changes by filing one Form 3115, and must follow the change in method of accounting provisions under Rev. Proc. 2002-9, or its successor. The taxpayer must complete all applicable sections of Form 3115, including sections that apply to the change to an overall accrual method and to the change to the NAE method, and must enter the automatic accounting method change numbers for both changes on Form 3115.

.02 Advance consent change in method of accounting.

(1) In general. A taxpayer within the scope of sections 3.01(6) or (7) of this revenue procedure must follow the advance consent change in method of accounting procedures in Rev. Proc. 97-27, or its successor.

(2) Concurrent change to an overall accrual method of accounting and a NAE method of accounting. A taxpayer within the scope of section 3.01(6) or (7) of this revenue procedure that wants to change to a NAE method of accounting (with or without also changing to a periodic system) and also wants to change to an overall accrual method of accounting or to an overall accrual method in conjunction with the recurring item exception for which the change to the overall accrual method is not allowed under an automatic consent procedure, must request to make both changes by filing one Form 3115, and must follow the change in method of accounting provisions in Rev. Proc. 97-27, or its successor. Only one user fee is required for these changes. The taxpayer must complete all applicable sections of Form 3115, including the sections that apply to the change to an overall accrual method and to the change to the NAE method.

.03 Procedures for certain adoptions by taxpayers.

(1) In general. Normally, taxpayers are not required to obtain advance consent in order to adopt a method of accounting for the first time. However, a taxpayer within the scope of section 3.01(8) of this revenue procedure must obtain advance consent of the Commissioner in order to adopt a NAE method other than a safe harbor method provided in § 1.448-2(f)(1) through (5). In order to obtain advance consent, a taxpayer must follow the procedures for a change in method of accounting. Specifically,

a taxpayer must file a Form 3115 and must comply with the following provisions of Rev. Proc. 97-27:

- (a) Section 3, Definitions;
- (b) Section 5, Procedures for Taxpayers not under Examination;
- (c) Section 8, General Application Procedures;
- (d) Section 10, Effect of Consent; and
- (e) Section 11, Review by District Director.

(2) Year of change. The year in which the taxpayer adopts the NAE method under this section 4.03 is treated as the “year of change” for purposes of the rules, filing deadlines, and procedures under Rev. Proc. 97-27.

SECTION 5. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 2002-9 is modified and amplified to include these automatic changes to a NAE method of accounting in the APPENDIX.

SECTION 6. EFFECTIVE DATE

This revenue procedure is effective for taxable years ending on or after August 31, 2006.

SECTION 7. DRAFTING INFORMATION

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