Part III

Administrative, Procedural, and Miscellaneous

26 CFR 601.204: Changes in accounting periods and in methods of accounting.
(Also: Part I, Sections 446, 460, 461, 481, 1011, 1012, 1016; 1.446-1, 1.460-1, 1.460-3, 1.460-4, 1.460-5, 1.461-1, and 1.461-4.)

Rev. Proc. 2023-9

SECTION 1. PURPOSE

This revenue procedure obsoletes Rev. Proc. 92-29, 1992-1 C.B. 748, and provides new rules and conditions for implementing the optional safe harbor method of accounting for real estate developers (developers) to determine when common improvement costs may be included in the basis of individual units of real property (units) in a real property development project (project) held for sale to determine the gain or loss from sales of those units (Alternative Cost Method). Under this revenue procedure, the Alternative Cost Method is a method of accounting under §§ 446 and 481 of the Internal Revenue Code (Code) and is an alternative to the general

requirements under § 461(h).[1] Under the Alternative Cost Method, a developer includes the share of the estimated cost of common improvements allocable to the units sold in the basis of such units regardless of whether the costs have been incurred under § 461(h), subject to the alternative cost limitations set forth in this revenue procedure. This revenue procedure also provides guidance on the application of the Alternative Cost Method to contracts accounted for under § 460 and the regulations thereunder.

SECTION 2. BACKGROUND

.01 Section 1011 provides, in part, that the adjusted basis for determining gain or loss from the sale or other disposition of property is the taxpayer's basis in the property, determined under § 1012, adjusted as provided in § 1016. Section 1012 provides that the basis of property is the cost of such property. Section 1.1016-2(a) provides that the cost or other basis is properly adjusted for any expenditure properly chargeable to a capital account, including the cost of improvements and betterments made to the property.

.02 A developer may allocate the costs of certain common improvements to the bases of lots held for sale "[i]f an analysis of the common improvements indicated that (1) the basic purpose of the taxpayer in constructing the common improvement is to induce sales of the lots and (2) the taxpayer does not retain too much ownership and control of the common improvements." *Norwest Corp. and Subsidiaries v. Commissioner,* 111 T.C. 105, 134-35 (1998). *See also* Rev. Rul. 68-478, 1968-2 C.B. 330; Rev. Rul. 81-83, 1981-1 C.B. 434.

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[1] Unless otherwise specified, all "section" or "§" references are to sections of the Code or the Income Tax Regulations (26 CFR part 1).

.03 Section 461(h)(1) provides that, in determining whether an amount has been incurred with respect to any liability during any taxable year, the all events test is not treated as met any earlier than when economic performance with respect to such liability occurs. The term "liability", as defined in §1.446-1(c)(1)(ii)(B), includes any item allowable as a deduction, cost, or expense for federal income tax purposes, as well as any amount otherwise allowable as a capitalized cost, as a cost taken into account in computing cost of goods sold, as a cost allocable to a long-term contract, or as any other cost or expense.

.04 Under § 461, developers cannot add common improvement costs to the basis of the benefitted units until such costs are incurred under § 461(h). Thus, any common improvement costs that have not been incurred under § 461(h) when the benefitted units are sold cannot be included in the basis of the units in determining the gain or loss resulting from the sales.

.05 On April 9, 1992, the Internal Revenue Service (IRS) issued Rev. Proc. 92-29, which provided procedures under which the IRS would consent to developers including the estimated cost of common improvements in the basis of units in a project sold without meeting the economic performance requirements of § 461(h) (92-29 alternative cost method). In order for a developer to receive consent to use the 92-29 alternative cost method for a project, the developer was required to file a request to use the 92-29 alternative cost method with the developer's applicable District Director on or before the due date of the developer's original federal income tax return (determined with regard to extensions of time) for the taxable year in which the first benefitted unit in the project was sold. The developer also had to attach a copy of the request to the

developer's timely filed (determined with regard to extensions of time) original federal income tax return for the taxable year. A request had to be filed for each project, and the request required detailed information about the developer, the project, and the common improvement cost calculations under the 92-29 alternative cost method. *See* section 6.04 of Rev. Proc. 92-29. Rev. Proc. 92-29 obsoleted Rev. Proc. 75-25, 1975-1 C.B. 720, with respect to sales of property after December 31, 1992.

.06 The use of the 92-29 alternative cost method was also conditioned on the developer's agreement to extend the statutory period of limitation for assessing any tax deficiency arising from employing that method for each taxable year in which the 92-29 alternative cost method was used. To satisfy this condition, the developer executed and filed a consent on Form 921, *Consent to Extend the Time to Assess Income Tax*, or Form 921-A, *Consent Fixing Period of Limitation On Assessment of Income and Profits Tax*, as applicable. In addition, developers were required to file annual statements with the District Director for each project for which the 92-29 alternative cost method was used. The annual statements required detailed information about the developer, the project, and updates to the common improvement cost calculations under the 92-29 alternative cost method. *See* section 8.02 of Rev. Proc. 92-29. The developer also had to attach a copy of the annual statement to the developer's timely filed (determined with regard to extensions of time) original federal income tax return for the taxable year. If the project could not be completed within the original estimated completion period, a developer was required to file a supplemental request for consent to extend the period to use the 92-29 alternative cost method and to agree to extend the statutory period of limitation to assess income tax for each additional taxable year

that the 92-29 alternative cost method was used.

.07 Section 460(a) generally requires that the taxable income from a long-term contract be determined under the percentage-of-completion method (PCM). Section 460(f)(1) defines a long-term contract to include any contract for the construction of property if the contract is not completed in the taxable year it is entered into. For this purpose, a contract is for the construction of property if (1) construction is required in order to fulfill a taxpayer's contractual obligations, and (2) the construction of the property was not completed when the contract was entered into. How the parties characterize their agreement, for example, as a contract for the sale of property, is irrelevant. Section 1.460-1(b)(2)(i). Nonetheless, a contract is not a construction contract if it requires the taxpayer to transfer land and the estimated total allocable contract costs attributable to the taxpayer's construction activities (exclusive of the cost of the land) are less than 10 percent of the total contract price (de minimis test). Section 1.460-1(b)(2)(ii). Accordingly, contracts for the sale of units that do not meet the de minimis test are long-term contracts for purposes of § 460.

.08 Section 460(e)(1) exempts from the required use of the PCM the following construction contracts (exempt construction contracts): (1) home construction contracts (defined in § 460(e)(5)) and (2) other construction contracts of taxpayers, other than tax shelters, who meet the § 448(c) gross receipts test, and who estimate that the contracts will be completed within two years of the contract commencement date (generally the date the taxpayer first incurs allocable contract costs). A long-term construction contract is a home construction contract if a taxpayer reasonably expects to attribute 80 percent or more of the estimated total allocable contract costs,

determined as of the close of the contracting year, to the construction of (1) dwelling units contained in buildings containing 4 or fewer dwelling units and (2) improvements to real property directly related to, and located at the site of, the dwelling units (80-percent test). Section 1.460-3(b)(2). A contract's share of common improvement costs is counted toward meeting the 80 percent test only if there are "dwelling unit costs." *Howard Hughes Co., LLC v. Commissioner*, 805 F.3d 175, 184-185 (5th Cir. 2015). An exempt construction contract may be accounted for under a number of "exempt methods," which include the completed contract method described in § 1.460-4(d) (CCM) and the accrual method. *See* § 1.460-4(c)(1).

.09 In general, for exempt construction contracts using the CCM, a taxpayer must annually allocate to each contract all costs that are incident to or necessary for the taxpayer's performance under the contract. Section 1.460-5(d). Upon contract completion, a taxpayer generally takes into account the gross contract price and those allocable contract costs that have been incurred. Section 1.460-4(d). A contract is completed upon the earlier of (1) use of the subject matter of the contract by the customer for its intended purpose (other than for testing) and at least 95 percent of the total allocable contract costs attributable to the subject matter have been incurred by the taxpayer; or (2) final completion and acceptance of the subject matter of the contract. Section 1.460-1(c)(3)(i).

.10 The Department of the Treasury (Treasury Department) and the IRS recognize that aspects of Rev. Proc. 92-29 are outdated due to the enactment of the Internal Revenue Service Restructuring and Reform Act of 1998, Public Law No. 105-206, 112 Stat. 685 (1998), and the Bipartisan Budget Act of 2015, Public Law No. 117-74, 129

Stat. 584 (2015). The Treasury Department and the IRS also recognize that certain terms and conditions in Rev. Proc. 92-29, including those described in section 2.06 of this revenue procedure, place additional administrative burdens on developers and the IRS. Lastly, the Treasury Department and the IRS recognize that the application of the 92-29 alternative cost method to contracts accounted for under § 460 may be unclear. Accordingly, this revenue procedure provides updates to Rev. Proc. 92-29 to reflect current law; to reduce the administrative, recordkeeping, and compliance burdens associated with the use of the 92-29 alternative cost method; and to clarify its application to contracts accounted for under § 460 and the regulations thereunder.

.11 Under this revenue procedure, the Alternative Cost Method is a method of accounting under § 446. Sections 446(e) and 1.446-1(c) require taxpayers to secure the consent of the Commissioner of Internal Revenue (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.

.12 This revenue procedure provides new rules and procedures for developers to use the Alternative Cost Method for certain common improvement costs. Developers that want to use the Alternative Cost Method generally will be required to apply the method to all qualifying projects in a trade or business instead of on a per-project basis as required under Rev. Proc. 92-29. Additionally, section 8 of this revenue procedure provides the exclusive procedures for taxpayers that want to change their method of accounting to apply the Alternative Cost Method. To ease the administrative burden

faced by taxpayers to comply with the change to the Alternative Cost Method for the first taxable year beginning after December 31, 2022, this revenue procedure (1) permits certain taxpayers to use a short Form 3115, *Application for Change in Accounting Method*, to make method changes to apply the Alternative Cost Method if each change results in a § 481(a) adjustment of zero, and (2) waives the eligibility rule in section 5.01(1)(f) of Rev. Proc. 2015-13, 2015-5 I.R.B. 419, which prohibits taxpayers from filing an automatic method change if the taxpayer has made or requested a change for the same item during the 5 taxable years ending with the year of change.

SECTION 3. SCOPE

.01 Scope. The Alternative Cost Method is available to developers using an overall accrual method of accounting that are contractually obligated or required by law to provide common improvements, as defined in section 4.02 of this revenue procedure, as part of a qualifying project, as defined in section 4.01 of this revenue procedure. The Alternative Cost Method must be applied to all projects in a trade or business that meet the definition of a qualifying project. That is, the Alternative Cost Method is applied on a trade or business-by-trade or business basis pursuant to § 1.446-1(d). However, the alternative cost limitation in section 5.03 of this revenue procedure is calculated on a project-by-project basis. Any common improvement costs incurred with respect to one qualifying project may not be included in the Alternative Cost Method calculations of a separate qualifying project.

SECTION 4. DEFINITIONS

.01 Qualifying Project.

(1) General Definition. For purposes of this revenue procedure, the term "qualifying project" means any project of a developer for which common improvement costs will be incurred, provided such costs are properly allocable to–

(a) contracts that are properly accounted for under the CCM and for which one or more benefitted units are the subject matter, and/or

(b) benefitted units, the sales of which are properly accounted for under an accrual method.

(2) Reasonable Method. For purposes of the definition of a qualifying project, a developer may use any reasonable method to define a project in light of the common improvements to be provided. For example, a developer is using a reasonable method to define a project when it separates commercial and residential projects that provide for different common improvements.

.02 Common Improvement. For purposes of this revenue procedure, the term "common improvement" means any real property or improvements to real property that benefit two or more units that are separately held for sale by a developer. The developer must be contractually obligated or required by law to provide the common improvement and must not be able to recover the cost of the common improvement through depreciation. *See* Rev. Rul. 76-247, 1976-1 C.B. 217, for guidance regarding the necessary contractual obligation. Examples of common improvements include streets, sidewalks, sewer lines, playgrounds, clubhouses, tennis courts, and swimming pools that the developer is contractually obligated or required by law to make, as long as the costs are not properly recoverable through depreciation. However, common improvement costs do not include, for example, the costs to manage, mow, maintain,

or repair the property, construction period interest, or property taxes.

.03 CCM Contract. For purposes of this revenue procedure, the term "CCM contract" means any contract that is properly accounted for under the CCM and for which one or more benefitted units in a qualifying project are the subject matter.

SECTION 5. APPLICATION OF ALTERNATIVE COST METHOD

.01 Developers Using an Accrual Method of Accounting. A developer that uses an accrual method to account for the sale of units in a qualifying project and meets the scope requirements of section 3 of this revenue procedure is permitted to include in the basis of units sold (or make an adjustment to income with respect to units sold in prior taxable years) their allocable share of the estimated cost of common improvements, as determined under section 5.03 of this revenue procedure, regardless of whether the costs are incurred under § 461(h), subject to the alternative cost limitation in section 5.04 of this revenue procedure.

.02 Developers Using CCM. A developer that uses the CCM to account for a CCM contract and meets the scope requirements of section 3 of this revenue procedure is permitted to treat a CCM contract's allocable share of the estimated cost of common improvements, as determined under section 5.03 of this revenue procedure, as incurred allocable contract costs for purposes of determining income under § 1.460-4(d)(1) in the CCM contract's completion year (or making an adjustment to income for CCM contracts completed in prior taxable years), regardless of whether the costs are incurred under § 461(h), subject to the alternative cost limitation in section 5.04 of this revenue procedure. However, the Alternative Cost Method is disregarded for purposes of determining the year in which a CCM contract is complete under § 1.460-1(c)(3)(i).

.03 Allocable Share of Estimated Cost of Common Improvements.

(1) Under the Alternative Cost Method, a developer allocates the estimated cost of common improvements to all the benefitted units in the qualifying project (and, in the case of a developer using the CCM, all the CCM contracts from the qualifying project). The allocation of the estimated cost of common improvements among the benefitted units (or CCM contracts) in the qualifying project is made using any method that is applied on a consistent basis within that qualifying project and reasonably reflects the benefits provided to the units (or the CCM contracts) in that qualifying project. For example, a pro rata allocation of the estimated cost of common improvements or an allocation of the estimated cost of common improvements based on the relative costs to be incurred for the benefitted unit, on the relative size of the benefitted unit, or on the relative fair market value of the benefitted unit may be reasonable. Additionally, an allocation of a portion of the estimated cost of common improvements for certain common improvements based on one of the foregoing approaches and a different portion of the estimated cost of common improvements for other common improvements based on another of the foregoing approaches may be reasonable. If so, such an allocation method must be applied consistently among all benefitted units (or CCM contracts) in the qualifying project, as indicated above.

(2) The "estimated cost of common improvements" as of the end of any taxable year is equal to the amount of common improvement costs incurred under § 461(h) as of the end of the taxable year, plus the amount of common improvement costs the developer reasonably anticipates it will incur under § 461(h) during the ten succeeding taxable years (ten-taxable year horizon). The estimated cost of common

improvements may change from taxable year to taxable year as, for example, (1) the developer performs obligations at costs that differ from its previous estimate, (2) the developer changes its estimate of costs, (3) the developer undertakes new legal obligations or is released from existing ones, and (4) a new taxable year is added to the ten-taxable year horizon for estimating costs. A developer may not adjust the estimated cost of common improvements for a prior taxable year when events after filing the prior year original federal income tax return show that the original estimate has been either understated or overstated. If, after the original return is filed, it is determined that a greater or lesser amount should have been claimed, the correction is made in and for the year the determination is made. The adjustment to the estimated cost of common improvements is allocated to all of the benefitted units (and/or CCM contracts) in the project, including units that were sold (or CCM contracts that were completed) in prior taxable years. In the case of units that were sold (or CCM contracts that were completed) in a prior taxable year, their allocable share of the adjustment gives rise to a current year adjustment to income rather than an amended return or an administrative adjustment request, subject to the alternative cost limitation under section 5.04 of this revenue procedure. *See* section 5.06(3), Example 3, of this revenue procedure.

.04 Alternative Cost Limitation.

(1) The sum of the amount of estimated cost of common improvements included in the basis of (or otherwise taken into account with respect to) all of the units in the qualifying project that have been sold as of the end of the taxable year, or treated as incurred allocable contract costs for purposes of determining income under § 1.460-

4(d)(1) for CCM contracts completed as of the end of the taxable year, may not exceed the total amount of common improvement costs that have been incurred, within the meaning of § 461(h), with respect to the qualifying project as of the end of the taxable year (alternative cost limitation). If the alternative cost limitation precludes a developer from including the entire allocable share of the estimated cost of common improvements in the basis of the units sold (or treating the entire allocable share of the estimated cost of common improvements as incurred allocable contract costs of completed CCM contracts) in that taxable year, the costs not included in such year may be taken into account in a subsequent taxable year to the extent additional common improvement costs have been incurred under § 461(h). The common improvement costs incurred in a subsequent year are allocated first to the units already sold (or CCM contracts already completed) and then to the units sold in such subsequent year (or CCM contracts completed in such subsequent year). *See* section 5.06(2), Example 2, of this revenue procedure.

(2) The alternative cost limitation must be applied on a project-by-project basis. Thus, the common improvement costs incurred with respect to one qualifying project may not be included in the alternative cost limitation of a second qualifying project.

.05 Other Provisions in the Code. The Alternative Cost Method does not affect the application of general capitalization rules to developers under §§ 263(a) and 263A. Thus, common improvement costs incurred under § 461(h) are allocated among the benefitted units and may provide the basis for additional computations (for example, interest capitalization under § 263A(f)).

.06 Examples. The following examples illustrate the application of the Alternative

Cost Method.

(1) Example 1. (a) Facts. Developer will build 10 houses as part of the same project on a tract of land. The project is expected to take 3 years to complete. Developer is contractually obligated to provide common improvements that will benefit all the houses on the tract equally. Developer estimates that the common improvement costs will total $500,000, and the estimate does not change during the project. The common improvement costs are not properly recoverable through depreciation by Developer. Pursuant to section 5.03 of this revenue procedure, Developer allocates the estimated cost of common improvements pro rata to each house. Accordingly, each house's allocable share of the estimated cost of the common improvements is $50,000 ($500,000/10 houses). During Year 1, Developer sells four houses and incurs, within the meaning of § 461(h), $250,000 of common improvement costs. In Year 2, Developer sells four houses and incurs, within the meaning of § 461(h), $150,000 of common improvement costs. In Year 3, Developer sells two houses and incurs, within the meaning of § 461(h), $100,000 of common improvement costs. Developer uses an accrual method of accounting to account for the sale of all 10 houses in the development project and uses the Alternative Cost Method.

(b) Year 1--(i) Alternative Cost Method Used. Because Developer used the Alternative Cost Method, Developer includes $200,000 of estimated cost of common improvements in the aggregate bases of the four houses sold during Year 1 in determining the gain or loss resulting from the sales. This amount is the allocable share of the estimated cost of common improvements for the four houses as of the end of Year 1, $200,000 ($50,000 x 4) and does not exceed the amount of the common

improvement costs incurred with respect to the qualifying project under § 461(h) as of the end of Year 1 (that is, the alternative cost limitation), $250,000.

(ii) Alternative Cost Method Not Used. If Developer had not used the Alternative Cost Method, Developer would allocate the $250,000 of common improvement costs incurred to all 10 houses in the project and only include $100,000 ($250,000/10 x 4) of common improvement costs in the aggregate bases of the houses sold during Year 1 in determining the gain or loss resulting from the sales.

(c) Year 2--(i) Alternative Cost Method Used. Because Developer used the Alternative Cost Method, Developer includes $200,000 of estimated cost of common improvements in the aggregate bases of the four houses sold during Year 2 in determining the gain or loss resulting from the sales. This amount is the allocable share of the estimated cost of common improvements as of the end of Year 2 for the four houses, $200,000 ($50,000 x 4). The total amount of estimated cost of common improvements included in the bases of all of the houses sold as of the end of Year 2, $400,000 ($200,000 in Year 1 + $200,000 in Year 2), does not exceed the amount of the common improvement costs incurred with respect to the qualifying project under § 461(h) as of the end of Year 2 (that is, the alternative cost limitation), $400,000.

(ii) Alternative Cost Method Not Used. If Developer had not used the Alternative Cost Method, it would allocate the $150,000 of common improvement costs incurred in Year 2 to all 10 houses in the project ($15,000 to each house). The $60,000 allocated to the four houses sold in Year 1 would be recovered as a reduction to Developer's income in Year 2. The $60,000 allocated to the 4 houses sold in Year 2 would be included in their aggregate adjusted bases (along with the $100,000 of

common improvement costs incurred in Year 1) in determining the gain or loss resulting from the sales. The remaining $30,000 allocated to the 2 houses that were not yet sold as of the end of Year 2 would be included in their aggregate adjusted bases and recovered when those houses are sold in Year 3.

(d) Year 3--(i) Alternative Cost Method Used. Because Developer used the Alternative Cost Method, Developer includes $100,000 of estimated cost of common improvements in the aggregate bases of the two houses sold during Year 3 in determining the gain or loss resulting from the sales. This amount is the allocable share of the estimated cost of common improvements as of the end of Year 3 for the two houses, $100,000 ($50,000 x 2). The total amount of estimated cost of common improvements included in the bases of all of the houses sold as of the end of Year 3, $500,000 ($200,000 in Year 1 + $200,000 in Year 2 + $100,000 in Year 3), does not exceed the amount of the common improvement costs incurred with respect to the qualifying project under § 461(h) as of the end of Year 3 (that is, the alternative cost limitation), $500,000.

(ii) Alternative Cost Method Not Used. If Developer had not used the Alternative Cost Method, it would allocate the $100,000 common improvement costs incurred in Year 3 to all 10 houses in the project ($10,000 to each house). The $80,000 allocated to the 8 houses sold in Year 1 and Year 2 would be recovered as a reduction to Developer's income in Year 3. The remaining $20,000 allocated to the 2 houses sold in Year 3 would be included in their aggregate adjusted bases (along with the $80,000 of common improvement costs incurred in Year 1 and Year 2 and allocated to such houses) in determining the gain or loss resulting from the sales.

(2) Example 2. (a) Facts. The facts are the same as in Example 1, except that the project is expected to take 4 years to complete, and Developer incurs, within the meaning of § 461(h), $30,000 of common improvement costs in Year 2, $130,000 of common improvement costs in Year 3, and $90,000 of common improvement costs in Year 4. In addition, Developer sells only one house in Year 3 and one house in Year 4.

(b) Year 1. Alternative Cost Method Used. The results in Year 1 are the same as in Example 1.

(c) Year 2. Alternative Cost Method Used. Because Developer used the Alternative Cost Method, Developer may include $80,000 of estimated cost of common improvements in the aggregate bases of the four houses sold during Year 2 in determining the gain or loss resulting from the sales. The total amount of estimated cost of common improvements allocable to all of the houses sold as of the end of Year 2, $400,000 ($200,000 in Year 1 + $200,000 in Year 2), exceeds the alternative cost limitation of $280,000 ($250,000 + $30,000) by $120,000 ($400,000 - $280,000). The estimated cost not yet taken into account because of the alternative cost limitation, $120,000, may be taken into account when common improvement costs are incurred in a subsequent year.

(c) Year 3. Alternative Cost Method Used. Because Developer used the Alternative Cost Method, Developer may take into account $130,000 of estimated cost of common improvements in Year 3. The total amount of estimated cost of common improvements allocable to all of the houses sold as of the end of Year 3, $450,000 ($200,000 in Year 1 + $200,000 in Year 2 + $50,000 in Year 3), exceeds the

alternative cost limitation of $410,000 ($250,000 + $30,000 + 130,000) by $40,000 ($450,000 - $410,000). Developer first allocates $120,000 of the estimated cost to the four houses sold in Year 2 and recovers the amount as a reduction to income in Year 3. Developer includes the remaining $10,000 ($130,000 - $120,000) in the basis of the house sold in Year 3 in determining the gain or loss resulting from the sale. The estimated cost not included in basis because of the alternative cost limitation, $40,000, may be taken into account when the remaining $90,000 of common improvement costs are incurred in Year 4.

(3) Example 3. (a) Facts. The facts are the same as in Example 1, except that in Year 2, after the filing of Developer's original federal income tax return for Year 1, Developer determines that the estimated cost for common improvements increased from $500,000 to $700,000. Further, during Year 2, Developer incurs, within the meaning of § 461(h), $340,000 of common improvement costs (rather than $150,000). In Year 3, after the filing of Developer's original federal income tax return for Year 2, Developer determines that the estimated cost for common improvements decreased from $700,000 to $625,000. During Year 3, Developer incurs, within the meaning of § 461(h), $35,000 of common improvement costs (rather than $100,000).

(b) Year 2. Alternative Cost Method Used. Developer does not amend its federal income tax return or file an administrative adjustment request for Year 1 to account for the change in the estimated cost of common improvements. The correction to the estimated cost of common improvements is made in Year 2. The $200,000 increase to the estimate of the cost of common improvements is allocated equally to all 10 homes in the project. The total amount of estimated cost of common

improvements taken into account for Year 2 is $360,000, comprised of $280,000 ($700,000/10 x 4) of estimated cost of common improvements included in the aggregate bases of the four houses sold during Year 2 plus $80,000 of the Year 2 increase to the estimate of the cost of common improvements that is allocated to the four houses sold in Year 1 ($20,000 x 4), which reduces Developer's income for Year 2. The total amount of estimated cost of common improvements included in the bases of (or otherwise taken into account with respect to) all of the houses sold as of the end of Year 2, $560,000 ($200,000 in Year 1 + $360,000 in Year 2), does not exceed the amount of the common improvement costs incurred with respect to the qualifying project under § 461(h) as of the end of Year 2 (that is, alternative cost limitation), $590,000.

(c) Year 3. Alternative Cost Method Used. Developer does not amend its federal income tax return or file an administrative adjustment request for Year 2 to account for the change in the estimated cost of common improvements. The correction to the estimated cost of common improvements is made in Year 3. The $75,000 downward adjustment to the estimate of the cost of common improvements is allocated equally to all 10 homes in the project. The total amount of estimated cost of common improvements taken into account in Year 3 is $65,000, which is comprised of $125,000 ($625,000/10 x 2) of common improvement costs included in the aggregate bases of the two houses sold during Year 3 minus $60,000 of the Year 3 decrease in the estimate of the cost of common improvements allocable to the eight houses sold in Year 1 and Year 2 ($7,500 x 8), which increases Developer's income in Year 3. The total amount of estimated cost of common improvements included in the bases of (or

otherwise taken into account with respect to) all of the houses sold as of the end of Year 3, $625,000 ($200,000 in Year 1 + $360,000 in Year 2 + $65,000 in Year 3), does not exceed the amount of the common improvement costs incurred with respect to the qualifying project under § 461(h) as of the end of Year 3 (that is, alternative cost limitation), $625,000.

(4) Example 4. (a) Facts. The facts are the same as in Example 1, except that the 10 houses are each the subject matter of a CCM contract. Each CCM contract requires Developer to construct a house and common improvements. In Years 1, 2, and 3, when Developer sells four, four and two houses, respectively, it has incurred, without regard to the Alternative Cost Method, at least 95 percent of the estimated allocable costs of each of the respective CCM contracts.

(b) Year 1--(i) Alternative Cost Method Used. Because Developer used the Alternative Cost Method, Developer treats $200,000 of estimated cost of common improvements as incurred allocable contract costs for purposes of determining income upon completion of the four CCM contracts in Year 1. This amount is the allocable share of the estimated cost of common improvements for the four CCM contracts completed in Year 1, $200,000 ($50,000 x 4), and does not exceed the amount of the common improvement costs incurred with respect to the qualifying project under § 461(h) as of the end of Year 1 (that is, the alternative cost limitation), $250,000.

(ii) Alternative Cost Method Not Used. If Developer had not used the Alternative Cost Method, Developer would have allocated the $250,000 of common improvement costs incurred to all 10 CCM contracts for houses in the project and only treated $100,000 ($250,000/10 x 4) of common improvement costs as incurred

allocable contract costs for purposes of determining income upon the completion of the four CCM contracts in Year 1.

(c) Year 2—(i) Alternative Cost Method Used. Because Developer used the Alternative Cost Method, Developer treats $200,000 of estimated cost of common improvements as incurred allocable contract costs for purposes of determining income upon completion of the four CCM contracts in Year 2. This amount is the allocable share of the estimated cost of common improvements for the four CCM contracts completed during Year 2, $200,000 ($50,000 x 4). The total amount of estimated cost of common improvements treated as incurred allocable contract costs for all eight CCM contracts completed as of the end of Year 2, $400,000 ($200,000 in Year 1 + $200,000 in Year 2), does not exceed the amount of the common improvement costs incurred with respect to the qualifying project under § 461(h) as of the end of Year 2 (that is, the alternative cost limitation), $400,000.

(ii) Alternative Cost Method Not Used. If Developer had not used the Alternative Cost Method, it would have allocated the $150,000 of common improvement costs incurred in Year 2 to all 10 CCM contracts ($15,000 to each contract). The $60,000 allocated to the four CCM contracts completed in Year 1 would have been recovered as a reduction to Developer's income in Year 2. The $60,000 allocated to the four CCM contracts completed in Year 2 would have been treated as incurred allocable contract costs for purposes of determining income upon completion of the contracts (along with the $100,000 of common improvement costs incurred in Year 1 and allocated to such contracts). The remaining $30,000 allocated to the two CCM contracts that were not yet completed as of the end of Year 2 would be included

in the allocable contract costs for such contracts and recovered when those contracts were completed in Year 3.

(d) Year 3--(i) Alternative Cost Method Used. Because Developer used the Alternative Cost Method, Developer treats $100,000 of estimated costs of common improvements as incurred allocable contract costs for purposes of determining income upon completion of the two CCM contracts in Year 3. This amount is the allocable share of the estimated cost of common improvements for the two CCM contracts completed during Year 3, $100,000 ($50,000 x 2). The total amount of estimated cost of common improvements treated as incurred allocable contract costs for all ten CCM contracts completed as of the end of Year 3, $500,000 ($200,000 in Year 1 + $200,000 in Year 2 + $100,000 in Year 3), does not exceed the amount of the common improvement costs incurred with respect to the qualifying project under § 461(h) as of the end of Year 3 (that is, the alternative cost limitation), $500,000.

(ii) Alternative Cost Method Not Used. If Developer had not used the Alternative Cost Method, it would have allocated the $100,000 common improvement costs incurred in Year 3 to all 10 CCM contracts ($10,000 to each contract). The $80,000 allocated to the eight CCM contracts completed in Year 1 and in Year 2 would have been recovered as a reduction to Developer's income in Year 3. The remaining $20,000 allocated to two CCM contracts completed in Year 3 would have been treated as incurred allocable contract costs for such contracts (along with the $80,000 of common improvement costs incurred in Year 1 and Year 2 and allocated to such contracts).

SECTION 6. RETENTION AND PRODUCTION OF RECORDS

.01 In General. A developer using the Alternative Cost Method must keep, and timely provide to the Commissioner upon request, records and books of account that are sufficient to establish compliance with the requirements of this revenue procedure. *See* § 1.6001-1. If a developer fails to provide the required records in a timely manner or fails to demonstrate reasonable cause for the failure to maintain and produce the required records, the developer's method of accounting for its common improvement costs may be changed at the discretion of the Commissioner to a proper method of accounting. *See* Rev. Proc. 2002-18, 2002-13 I.R.B. 678.

.02 Sufficiency of Records. The records and books of account that are sufficient to establish compliance with the requirements of this revenue procedure will include sufficient information to support (1) the estimated cost of common improvements for each qualifying project, including documentation showing how the developer determined the estimated cost of common improvements and that the estimate was reasonable, and any changes to that estimate, (2) the allocation of the estimated cost of common improvements to each of the benefitted houses, parcels or lots in the qualifying project (and to each CCM contract), (3) the application of the alternative cost limitation to the qualifying project, and (4) the taxpayer's contractual obligation or legal requirement to provide the common improvements.

.03 Retention Period for Records. Pursuant to § 1.6001-1(e), all books and records required to be maintained in section 6.02 of this revenue procedure are required to be retained so long as the contents thereof may become material in the administration of any internal revenue law. For this purpose, such books and records need to be retained, at a minimum, as long as costs of the qualifying project may be incurred or

taken into account and for 3 years after the filing of the federal tax return for the last taxable year in which the costs of the qualifying project may be incurred or taken into account.

SECTION 7. TAXPAYERS THAT DO NOT USE THE ALTERNATIVE COST METHOD

A developer that fails to substantially comply with the provisions of this revenue procedure, including a developer whose estimates of common improvement costs are unreasonable under the circumstances, will not be permitted to use the Alternative Cost Method and therefore must include only common improvement costs that have been incurred under § 461(h) in the basis of benefitted units (or in allocable contract costs) of a project for the purpose of determining the gain or loss resulting from the sale of the units (or income upon CCM contract completion).

SECTION 8. CHANGE IN METHOD OF ACCOUNTING

.01 In general. The Alternative Cost Method is a method of accounting subject to § 446 and the regulations under § 446. A change to the Alternative Cost Method as provided in this revenue procedure is a change in method of accounting to which §§ 446(e) and 481 apply. An eligible taxpayer that wants to change to the Alternative Cost Method as defined in section 5 of this revenue procedure, or that wants to change from the 92-29 alternative cost method, must use the automatic change procedures in Rev. Proc. 2015-13 or its successor.

.02 Automatic change procedures. Rev. Proc. 2022-14 is modified to add new section 20.14 to read as follows:

.14 Alternative Cost Method.

(1) Description of change. This change applies to a taxpayer that wants to

change its method of accounting for common improvement costs either to (1) use the Alternative Cost Method in accordance with Rev. Proc. 2023-9; or (2) discontinue using the alternative cost method under Rev. Proc. 92-29 (92-29 alternative cost method) and instead account for common improvement costs using an accrual method of accounting under § 461.

(2) Applicability. This change applies to a taxpayer:

(a) that wants to change to the Alternative Cost Method described in Rev. Proc. 2023-9, for all of its qualifying projects within a trade or business, including taxpayers that want to change their method of allocating adjustments to the estimated cost of common improvements for all of their qualifying projects within a trade or business;

(b) that, on the first day of the first taxable year beginning after December 31, 2022, in the same trade or business, uses the 92-29 alternative cost method for one or more qualifying projects that are in progress and an accrual method under § 461 to account for common improvement costs for one or more qualifying projects that are in progress (legacy rule). For purposes of this section, a qualifying project is in progress if the developer has sold at least one unit in the project in a prior taxable year (or in the case of a developer that uses the completed contract method, has completed at least one contract in the project in a prior taxable year) and holds units in the project available for sale during the taxable year. In this situation, the taxpayer is not required to change to the Alternative Cost Method for such qualifying projects in progress using an accrual method under § 461 as long as all new qualifying projects in the trade or business are accounted for using the Alternative Cost Method in accordance with Rev. Proc. 2023-9; or

(c) that, on the first day of the first taxable year beginning after December 31, 2022, wants to change from the 92-29 alternative cost method to an accrual method under § 461 for all of its qualifying projects in a trade or business.

(3) Inapplicability. This change does not apply to a taxpayer that is using the Alternative Cost Method described in Rev. Proc. 2023-9 that wants to change its method of allocating the estimated cost of common improvements among the benefitted units in the qualifying project (and in the case of a taxpayer using the completed contract method described in § 1.460-4(d) (CCM), a taxpayer that wants to change its method of allocating the estimated cost of common improvements among all the CCM contracts, as defined in section 4.03 of Rev. Proc. 2023-9, in the qualifying project).

(4) Short Form 3115 in lieu of a standard Form 3115 for certain taxpayers.

(a) Applicability. The procedures described in section 20.14(4)(b) may be used by a taxpayer to make a change in method of accounting described in section 20.14(2)(a) or (b) for the taxpayer's first taxable year beginning after December 31, 2022, provided the taxpayer otherwise meets the requirements of this section 20.14(4)(a). A taxpayer may use a short Form 3115 in lieu of a standard Form 3115 only if the § 481(a) adjustment required by each such change is zero, and the taxpayer either: (1) is currently using the 92-29 alternative cost method for all qualifying projects and wants to change to the Alternative Cost Method in accordance with Rev. Proc. 2023-9 for all trades or businesses with such qualifying projects for the taxpayer's first taxable year beginning after December 31, 2022; or (2) wants to apply the legacy rule described in section 20.14(2)(b) of this revenue procedure to change to the Alternative

Cost Method in accordance with Rev. Proc. 2023-9 for the taxpayer's first taxable year beginning after December 31, 2022. Notwithstanding any provisions of this section 20.14, a taxpayer making more than one change in method of accounting under this revenue procedure for the same year of change is not permitted to net the § 481(a) adjustments to determine if the taxpayer meets the requirements to use the streamlined method change procedures.

(b) Short Form 3115. A taxpayer making a change under section 20.14(4)(a) for the taxpayer's first taxable year beginning after December 31, 2022, is required to complete only the following information on Form 3115 (Rev. 2018):

(i) The identification section of page 1 (above Part I);

(ii) The signature section at the bottom of page 1;

(iii) Part I, line 1(a); and

(iv) For taxpayers using the legacy rule, Part II, line 16(a) identifying any qualifying projects in progress for which the taxpayer used the 92-29 alternative cost method and any qualifying projects in progress for which taxpayer will continue to use an accrual method of accounting.

(5) Eligibility rule temporarily inapplicable. The eligibility rule in section 5.01(1)(f) of Rev. Proc. 2015-13, 2015-5 I.R.B. 419, does not apply to the changes described in this section 20.14 for the taxpayer's first taxable year beginning after December 31, 2022.

(6) Examples. The following examples illustrate the application of the Alternative Cost Method in accordance with Rev. Proc. 2023-9.

(a) Example 1. (i) Facts. Developer, a calendar year taxpayer that uses an

overall accrual method of accounting, is in the business of developing residential subdivisions. As of December 31, 2022, Developer has two subdivision projects in progress in its only trade or business, Project A and Project B; both projects are separate qualifying projects, as defined in section 4.01 of Rev. Proc. 2023-9. Developer sold the first lots in both projects during the 2022 taxable year. Developer requested consent to use the 92-29 alternative cost method for Project A in 2022. Developer has not requested consent to use the 92-29 alternative cost method for Project B.

(ii) Application of the Alternative Cost Method in accordance with Rev. Proc. 2023-9 for all qualifying projects. Developer wants to use the Alternative Cost Method for both qualifying projects. Developer must file a change in method of accounting using the automatic change in method of accounting procedures of this section 20.14 and must calculate the § 481(a) adjustment resulting from changing the method of accounting for Project A and Project B, if any.

(b) Example 2. Application of the legacy rule. The facts are the same as in Example 1, except that Developer wants to use the Alternative Cost Method for Project A but not for Project B. Pursuant to section 20.14 of this revenue procedure, Developer does not have to apply the Alternative Cost Method to Project B. However, if the Developer applies the Alternative Cost Method for Project A, then the Developer must also apply the Alternative Cost Method to all new qualifying projects in its trade or business for taxable years beginning after December 31, 2022. Developer must also calculate the § 481(a) adjustment resulting from changing the method of accounting for Project A, if any.

(7) Designated automatic accounting method change number.

(a) Change to the Alternative Cost Method in accordance with Rev. Proc. 2023-9. The designated automatic accounting method change number for a change to the Alternative Cost Method in accordance with section 20.14(2)(a) is "266."

(b) Legacy rule. The designated automatic accounting method change number for a taxpayer that wants to apply the legacy rule described in section 20.14(2)(b) for the taxpayer's first taxable year beginning after December 31, 2022, is "267."

(c) Change to an accrual method. The designated automatic accounting method change number for a change to an accrual method in accordance with section 20.14(2)(c) for the taxpayer's first taxable year beginning after December 31, 2022, is "268."

(8) Contact information. For further information regarding a change under this section 20.14, contact Maria Castillo Valle at (202) 317-7003 (not a toll-free call).

SECTION 9. EFFECT ON OTHER DOCUMENTS

.01 This revenue procedure obsoletes Rev. Proc. 92-29 for taxable years beginning after December 31, 2022.

.02 This revenue procedure modifies and amplifies Rev. Proc. 2022-14.

SECTION 10. EFFECTIVE DATE

.01 This revenue procedure is effective for taxable years beginning after December 31, 2022.

.02 Developers that have received consent pursuant to Rev. Proc. 92-29 to use the 92-29 alternative cost method cannot use the 92-29 alternative cost method for taxable years beginning after December 31, 2022. Developers who wish to use the Alternative

Cost Method must follow the rules and satisfy the conditions in this revenue procedure for taxable years beginning after December 31, 2022.

SECTION 11. PAPERWORK REDUCTION ACT

The collection of information contained in this revenue procedure has been submitted to the Office of Management and Budget for review under OMB control number 1545-0123 in accordance with the Paperwork Reduction Act (44 U.S.C. 3507(d)). 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 collection of information in this revenue procedure is in section 8. 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.

SECTION 12. DRAFTING INFORMATION

The principal author of this revenue procedure is Maria Castillo Valle of the Office of Associate Chief Counsel (Income Tax & Accounting). For further information regarding this revenue procedure, contact Ms. Castillo Valle at (202) 317-7003.