Internal Revenue
bulletin

Bulletin No. 1998–51
December 21, 1998

HIGHLIGHTS OF THIS ISSUE

These synopses are intended only as aids to the reader in identifying the subject matter covered. They may not be relied upon as authoritative interpretations.

INCOME TAX

Rev. Rul. 98–60, page 6.

REIT impermissible tenant service income. If a REIT receives impermissible tenant service income of one percent or less of its total income from a property, then only the impermissible tenant service income fails to qualify as rents from real property. If the impermissible tenant service income exceeds one percent, then all income derived by the REIT from that property fails to qualify as rents from real property.

Rev. Rul. 98–61, page 8.

Interest rates; underpayments and overpayments. The rate of interest determined under section 6621 of the Code for the calendar quarter beginning January 1, 1999, will be 7 percent for overpayment (6 percent in the case of a corporation), 7 percent for underpayments, and 9 percent for large corporate underpayments. The rate of interest paid on the portion of a corporate overpayment exceeding $10,000 is 4.5 percent.

Rev. Rul. 98–62, page 4.

LIFO; price indexes; department stores. The October 1998 Bureau of Labor Statistics price indexes are accepted for use by department stores employing the retail inventory and last-in, first-out inventory methods for valuing inventories for tax years ended on, or with reference to, October 31, 1998.

EXEMPT ORGANIZATIONS

Announcement 98–112, page 46.

A list is given of organizations now classified as private foundations.

ADMINISTRATIVE

Rev. Proc. 98–60, page 16.

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

Notice 98–61, page 13.

Innocent spouse equitable relief. Interim guidance is provided for taxpayers seeking equitable relief from federal tax liability under section 6015(f) or 66(c) of the Code.

Notice 98–62, page 15.

The Service has the option of serving a continuous levy under section 6331(h) of the Code, although no levies have been served at this time. When such levies are served in the future, procedures will require that they be identified as section 6331(h) levies.

Notice 98–63, page 15.

Return preparers; identifying numbers. Individual income tax return preparers are reminded that, until the Service implements a system of providing alternative identifying numbers, they must continue to provide their social security numbers on returns and claims for refund prepared by them to satisfy the identifying number requirement of section 6109 of the Code.

Announcement 98–113, page 48.

The printed version of Announcement 98–106, 1998–48 I.R.B. 9, relating to changes to codes for Roth IRAs on Form 1099–R, is corrected in its entirety.

Finding Lists begin on page 50.

Department of the Treasury
Internal Revenue Service

The IRS Mission

Provide America's taxpayers top quality service by helping them understand and meet their tax responsibilities and by applying the tax law with integrity and fairness to all.

Statement of Principles of Internal Revenue Tax Administration

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

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

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

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

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

Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest. It is published weekly and may be obtained from the Superintendent of Documents on a subscription basis. Bulletin contents of a permanent nature are consolidated semiannually into Cumulative Bulletins, which are sold on a single-copy basis.

It is the policy of the Service to publish in the Bulletin all substantive rulings necessary to promote a uniform application of the tax laws, including all rulings that supersede, revoke, modify, or amend any of those previously published in the Bulletin. All published rulings apply retroactively unless otherwise indicated. Procedures relating solely to matters of internal management are not published; however, statements of internal practices and procedures that affect the rights and duties of taxpayers are published.

Revenue rulings represent the conclusions of the Service on the application of the law to the pivotal facts stated in the revenue ruling. In those based on positions taken in rulings to taxpayers or technical advice to Service field offices, identifying details and information of a confidential nature are deleted to prevent unwarranted invasions of privacy and to comply with statutory requirements.

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations, court decisions, rulings, and procedures must be considered, and Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The Bulletin is divided into four parts as follows:

Part I.—1986 Code.
This part includes rulings and decisions based on provisions of the Internal Revenue Code of 1986.

Part II.—Treaties and Tax Legislation.
This part is divided into two subparts as follows: Subpart A, Tax Conventions, and Subpart B, Legislation and Related Committee Reports.

Part III.—Administrative, Procedural, and Miscellaneous.
To the extent practicable, pertinent cross references to these subjects are contained in the other Parts and Subparts. Also included in this part are Bank Secrecy Act Administrative Rulings. Bank Secrecy Act Administrative Rulings are issued by the Department of the Treasury's Office of the Assistant Secretary (Enforcement).

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

The first Bulletin for each month includes a cumulative index for the matters published during the preceding months. These monthly indexes are cumulated on a semiannual basis and are published in the first Bulletin of the succeeding semiannual period, respectively.

For sale by the Superintendent of Documents, U.S. Government Printing Office, Washington, DC 20402.

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

Section 162.—Trade or Business Expenses

What procedures must a lawyer, handling cases on a contingent fee basis, use to obtain automatic consent of the Commissioner to change its method of accounting for advances paid to clients. See Rev. Proc. 98–60, page 16.

Section 165.—Losses

26 CFR 1.165–2: Obsolescence of nondepreciable property.

What procedures must a taxpayer use to obtain automatic consent of the Commissioner to change its method of accounting for package design costs. See Rev. Proc. 98–60, page 16.

Section 166.—Bad Debts

What procedures must a taxpayer use to obtain automatic consent of the Commissioner to change from the § 585 reserve method of accounting to the § 166 specific charge-off method. See Rev. Proc. 98–60, page 16.

Section 167.—Depreciation

26 CFR 1.167(a)–11: Depreciation based on class lives and asset depreciation ranges for property placed in service after December 31, 1970.

26 CFR 1.167(e)–1: Change in method.

What procedures must a taxpayer use to obtain automatic consent of the Commissioner to change its method of accounting for depreciation. See Rev. Proc. 98–60, page 16.

Section 168.—Accelerated Cost Recovery System

What procedures must a taxpayer use to obtain automatic consent of the Commissioner to change its method of accounting for depreciation. See Rev. Proc. 98–60, page 16.

Section 174.—Research and Experimental Expenditures

26 CFR 1.174–1: Research and exprimental expenditures in general.

26 CFR 1.174–3: Treatment as expenses.

26 CFR 1.174–4: Treatment as deferred expenses.

What procedures must a taxpayer use to obtain automatic consent of the Commissioner to change its method of accounting for research and experimental expenditures. See Rev. Proc. 98–60, page 16.

Section 197.—Amortization of Goodwill and Other Intangibles

What procedures must a taxpayer use to obtain automatic consent of the Commissioner to change its method of accounting for amortization. See Rev. Proc. 98–60, page 16.

Section 263.—Capital Expenditures

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

What procedures must a taxpayer use to obtain automatic consent of the Commissioner to change its method of accounting for package design costs. See Rev. Proc. 98–60, page 16.

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

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

What procedures must a taxpayer use to obtain automatic consent of the Commissioner to change its method of accounting. See Rev. Proc. 98–60, page 16.

26 CFR 1.263A–3: Rules relating to property acquired for resale.

What procedures must a taxpayer use to obtain automatic consent of the Commissioner to change its method of accounting. See Rev. Proc. 98–60, page 16.

Section 446.—General Rule for Methods of Accounting

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

What procedures must a taxpayer use to obtain automatic consent of the Commissioner to change its method of accounting for package design costs. See Rev. Proc. 98–60, page 16.

Section 451.—General Rule for Taxable Year of Inclusion

What procedures must a taxpayer use to obtain automatic consent of the Commissioner to change its method of accounting for the income from an advance payment related to the sale of a multi-year service warranty contract. See Rev. Proc. 98–60, page 16.

Section 454.—Obligations Issued at a Discount

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

What procedures must a taxpayer use to obtain automatic consent of the Commissioner to change its method of accounting for the interest income on Series E or EE U.S. savings bonds. See Rev. Proc. 98–60, page 16.

Section 455.—Prepaid Subscription Income

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

What procedures must a taxpayer use to obtain automatic consent of the Commissioner to change its method of accounting for prepaid subscription income. See Rev. Proc. 98–60, page 16.

Section 461.—General Rule for Taxable Year of Deduction

26 CFR 1.461–4: Economic performance.

What procedures must a taxpayer use to obtain automatic consent of the Commissioner to change its method of accounting. See Rev. Proc. 98–60, page 16.

Section 471.—General Rule for Inventories

26 CFR 1.471–1: Need for inventories.

26 CFR 1.471–2: Valuation of inventories.

26 CFR 1.471–3: Inventories at cost.

What procedures must a taxpayer use to obtain automatic consent of the Commissioner to change its method of accounting for certain cash discounts. See Rev. Proc. 98–60, page 16.

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

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

LIFO; price indexes; department stores. The October 1998 Bureau of Labor Statistics price indexes are accepted for use by department stores employing the retail inventory and last-in, first-out inventory methods for valuing inventories for tax years ended on, or with reference to, October 31, 1998.

Rev. Rul. 98–62

The following Department Store Inventory Price Indexes for October 1998 were issued by the Bureau of Labor Statistics. The indexes are accepted by the Internal Revenue Service, under § 1.472–1(k) of the Income Tax Regulations and Rev. Proc. 86–46, 1986–2 C.B. 739, for appropriate application to inventories of department stores employing the retail inventory and last-in, first-out inventory methods for tax years ended on, or with reference to, October 31, 1998.

The Department Store Inventory Price Indexes are prepared on a national basis

and include (a) 23 major groups of departments, (b) three special combinations of the major groups - soft goods, durable goods, and miscellaneous goods, and (c) a store total, which covers all departments, including some not listed separately, except for the following: candy, food, liquor, tobacco, and contract departments

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

Groups	Oct. 1997	Oct. 1998	Percent Change from Oct.1997 to Oct. 1998[1]
1. Piece Goods	534.5	548.9	2.7
2. Domestics and Draperies	638.4	637.5	–0.1
3. Women's and Children's Shoes	672.2	679.2	1.0
4. Men's Shoes	910.2	921.6	1.3
5. Infants' Wear	615.5	640.2	4.0
6. Women's Underwear	560.1	572.6	2.2
7. Women's Hosiery	301.6	308.9	2.4
8. Women's and Girls' Accessories	541.7	551.6	1.8
9. Women's Outerwear and Girls' Wear	431.3	423.5	–1.8
10. Men's Clothing	625.3	620.1	–0.8
11. Men's Furnishings	601.0	607.8	1.1
12. Boys' Clothing and Furnishings	505.9	521.0	3.0
13. Jewelry	995.5	982.7	–1.3
14. Notions	844.4	757.6	–10.3
15. Toilet Articles and Drugs	916.4	946.4	3.3
16. Furniture and Bedding	666.2	673.7	1.1
17. Floor Coverings	578.2	601.0	3.9
18. Housewares	812.1	817.1	0.6
19. Major Appliances	243.3	238.3	–2.1
20. Radio and Television	74.5	70.6	–5.2
21. Recreation and Education[2]	108.6	102.8	–5.3
22. Home Improvements[2]	132.7	129.5	–2.4
23. Auto Accessories[2]	107.9	107.9	0.0
Groups 1 – 15: Soft Goods	610.1	612.7	0.4
Groups 16 – 20: Durable Goods	463.9	460.5	–0.7
Groups 21 – 23: Misc. Goods[2]	111.6	107.3	–3.9
Store Total[3]	558.5	556.9	–0.3

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

DRAFTING INFORMATION

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

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26 CFR 1.472–6: Change from LIFO inventory method.

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

What procedures must a taxpayer use to obtain automatic consent of the Commissioner to change from the LIFO method of accounting for all its LIFO inventory, or to change to an alternate LIFO inventory method. See Rev. Proc. 98–60, page 16.

Section 475.—Mark to Market Accounting Method for Dealers in Securities

What procedures must a taxpayer use to obtain automatic consent of the Commissioner to change its method of accounting for certain mark to market items for dealers in securities. See Rev. Proc. 98–60, page 16.

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

26 CFR 1.481–1: Adjustments in general.

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

What procedures must a taxpayer use to obtain automatic consent of the Commissioner to change a method of accounting. See Rev. Proc. 98–60, page 16.

Section 585.—Reserves for Losses on Loans of Banks

What procedures must a taxpayer use to obtain automatic consent of the Commissioner to change from the § 585 reserve method of accounting to the § 166 specific charge-off method. See Rev. Proc. 98–60, page 16.

Section 1272.—Current Inclusion in Income of Original Issue Discount

26 CFR 1.1272–1: Current inclusion of OID in income.

What procedures must a taxpayer use to obtain automatic consent of the Commissioner to change its method of accounting for OID income. See Rev. Proc. 98–60, page 16.

Section 1273.—Determination of Amount of Original Issue Discount

26 CFR 1.1273–1: Definition of OID.

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

What procedures must a taxpayer use to obtain automatic consent of the Commissioner to change its method of accounting for certain *de minimis* original issue discount. See Rev. Proc. 98–60, page 16.

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

What procedures must a taxpayer use to obtain automatic consent of the Commissioner to change its method of accounting for interest income on short-term obligations, or for stated interest on short-term loans of cash method banks in the Eighth Circuit. See Rev. Proc. 98–60, page 16.

Section 1363.—Effect of Election on Corporation

What procedures must a taxpayer use to obtain automatic consent of the Commissioner to change its method of accounting. See Rev. Proc. 98–60, page 16.

Section 856.—Definition of Real Estate Investment Trust

26 CFR 1.856–1: Definition of a real estate investment trust.

REIT impermissible tenant service income. If a REIT receives impermissible tenant service income equal to or less than one percent of its total income from a property, then only the impermissible tenant service income fails to qualify as rents from real property. If the impermissible tenant service income exceeds one percent, then all income derived by the REIT from that property fails to qualify as rents from real property.

Rev. Rul. 98–60

ISSUE

If a real estate investment trust (REIT) receives "impermissible tenant service income" within the meaning of § 856(d)(7) of the Internal Revenue Code for services rendered by the REIT to one or more tenants of a multi-tenant property, in what situations will other amounts received by the REIT with respect to the property continue to qualify as "rents from real property" under § 856(d)?

FACTS

Situation 1

Y, a REIT that files its returns on a calendar year basis, owns a high-rise apartment building, Building *P*. Building *P* has 100 apartments, of which 95 are standard, unfurnished apartments rented on an annual basis. The remaining five apartments are guest apartments. A guest apartment is a furnished apartment available for lease on a short-term basis to guests of tenants. Employees of *Y* render maid service in connection with the lease of guest apartments. *Y* also provides heat and light to all of the tenants in Building *P*. *Y* does not render any other services to the tenants of Building *P* or engage in any other activity at Building *P* that could give rise to impermissible tenant service income.

For 1998, *Y* derives a total of $1,000*x* from all the tenants of Building *P*, of which $90*x* is from visitors who rented guest apartments. Of the $90*x* received from tenants of the guest apartments, the amount received with respect to maid service is $9*x*, which is greater than 150 percent of the direct costs of *Y* in rendering the service. Of the $1,000*x* received from all the tenants, the amount paid to *Y* for heat and light is $100*x* ($1*x* for each unit, including the guest units), which also is greater than 150 percent of the direct costs of *Y* for providing heat and light. The amount of rent attributable to personal property leased in connection with the rental of each guest apartment in Building *P* for 1998 does not exceed 15 percent of the total rent for such apartment attributable to both the real property and the personal property as provided in § 856(d)(1).

Situation 2

The facts are the same as those in *Situation 1* except that *Y* derives $110*x* from visitors who rented guest apartments. Of the $110*x* received from tenants of the guest apartments, the amount received with respect to maid service is $11*x*,

which is greater than 150 percent of the direct costs of *Y* in rendering the service.

LAW AND ANALYSIS

For an entity to qualify as a REIT, the entity must derive at least 95 percent of its gross income from certain sources described in § 856(c)(2) and at least 75 percent of its gross income from certain sources described in § 856(c)(3). Rents from real property are among the sources described in both § 856(c)(2) and § 856(c)(3).

Section 856(d)(1) provides that rents from real property include (subject to the exclusions in § 856(d)(2)): (i) rents from interests in real property, (ii) charges for services customarily furnished or rendered in connection with the rental of real property (whether or not the charges are separately stated), and (iii) rent attributable to personal property that is leased under, or in connection with, a lease of real property, but only if the rent attributable to the personal property for the taxable year does not exceed 15 percent of the total rent for the year attributable to both the real and personal property leased under, or in connection with, the lease.

Section 856(d)(2)(C) (as modified by the Taxpayer Relief Act of 1997) excludes from the definition of rents from real property any impermissible tenant service income as defined in § 856(d)(7). Section 856(d)(7)(A) provides that impermissible tenant service income means, with respect to any real or personal property, any amount received or accrued directly or indirectly by a REIT for furnishing or rendering services to the tenants of the property or managing or operating the property.

Section 856(d)(7)(C)(i) excludes from impermissible tenant service income amounts received for services furnished or rendered, or management or operation provided, through an independent contractor from whom the REIT itself does not derive or receive any income.

Section 856(d)(7)(C)(ii) excludes from the definition of impermissible tenant service income any amount that would be excluded from unrelated business taxable income (UBTI) under § 512(b)(3) if received by an organization described in § 511(a)(2). Section 512(b)(3)(A)(i) excludes rents from real property from UBTI. Section 1.512(b)–1(c)(5) of the Income Tax Regulations provides, however, that payments for the occupancy of space where services are also rendered to the occupant are not rents from real property. Generally, services are considered rendered to the occupant if they are primarily for the occupant's convenience and are other than those usually or customarily rendered in connection with the rental of space for occupancy only. Under § 1.512(b)–1(c)(5), the provision of maid service is given as an example of a service that is considered rendered to the occupant. Maid service provided by an employee of a REIT is, therefore, an impermissible tenant service that gives rise to impermissible tenant service income under § 856(d)(7). Conversely, under § 1.512(b)–1(c)(5), the provision of heat and light is given as an example of a service that is not considered rendered to the occupant. Accordingly, the provision of heat and light by a REIT is a permissible tenant service.

Section 1.512(b)–1(c)(5) taints all payments received under a lease as other than rents from real property where any impermissible tenant service is provided to the tenant. Accordingly, a strict application of § 1.512(b)–1(c) in the context of § 856(d)(7)(C)(ii) could cause all tenant service income (that is, service income and income from management and operations) derived under a lease to fail to qualify for this exception where any impermissible tenant service is rendered to the tenant. However, the legislative history discussing § 856(d)(7) indicates that only income attributable to impermissible tenant services should be treated as impermissible tenant service income after the application of § 856(d)(7)(C)(ii) (unless § 856(d)(7)(B) applies). H.R. Conf. Rep. No. 105–220, 105th Cong., 1st Sess. 696 (1997) ("The value of the *impermissible services* may not exceed one percent of the gross income from the property" (emphasis added)). Accordingly, under § 856(d)(7)(C)(ii), an amount attributable to a service or activity is excluded from impermissible tenant service income unless the service or activity to which that amount relates would cause the related rents to be treated as UBTI if received by an organization described in § 511(a)(2).

Section 856(d)(7)(D) provides that the amount treated as received for any service (or management or operation) must not be less than 150 percent of the direct cost of the REIT in furnishing or rendering the service (or providing the management or operation).

Section 856(d)(7)(B) provides that, if the amount of impermissible tenant service income with respect to a property for any taxable year exceeds one percent of all amounts received or accrued during such taxable year directly or indirectly by the REIT with respect to the property, the impermissible tenant service income of the REIT with respect to the property includes all such amounts.

In *Situation 1*, the $9*x* attributable to the impermissible tenant services rendered to tenants of the guest apartments is impermissible tenant service income within the meaning of § 856(d)(7). Thus, pursuant to § 856(d)(2)(C), the $9*x* fails to qualify as rents from real property. Because the provision of heat and light is a permissible tenant service, no amount attributable to this service (including amounts paid by tenants of the guest units) is treated as impermissible tenant service income in applying the one percent *de minimis* rule. The $9*x* of impermissible tenant service income received by *Y* from Building *P* for 1998 does not exceed one percent of the $1,000*x* received or accrued directly or indirectly by *Y* with respect to Building *P*. Therefore, the rendering of impermissible tenant services to tenants of the guest apartments does not prevent otherwise qualifying amounts received by *Y* from the tenants of Building *P* (including tenants of the guest apartments) from qualifying as rents from real property under § 856(d), and the total impermissible tenant service income received with respect to Building *P* is $9*x*.

In *Situation 2*, the $11*x* attributable to the impermissible tenant services rendered to tenants of the guest apartments is impermissible tenant service income within the meaning of § 856(d)(7). The $11*x* of impermissible tenant service income received by *Y* from Building *P* for 1998 exceeds one percent of the $1,000*x* received or accrued directly or indirectly by *Y* with respect to Building *P*. Therefore, all $1,000*x* derived by *Y* from Building *P* is impermissible tenant service income that, pursuant to § 856(d)(2)(C), fails to qualify as rents from real property.

Rev. Rul. 72–353, 1972–2 C.B. 413, illustrates how § 856(d)(2)(A), which ex-

cludes rents derived under net profit leases from the definition of rents from real property, is applied in a multiple tenant situation. In Rev. Rul. 72–353, a REIT leased office space in a building to 10 different tenants under separate leases. Nine of the leases provided for a fixed-sum rental. The tenth lease, however, provided for a rental based on a percentage of the tenant's net profits. Rev. Rul. 72–353 holds that the payments by the tenth tenant to the REIT, which do not qualify as rents from real property, do not prevent amounts paid to the REIT by the other tenants of the office building that otherwise qualified as rents from real property from so qualifying.

Section 856(d)(7)(B) allows a REIT to provide a limited amount of impermissible tenant services with respect to property without causing all of the income from the property to fail to qualify as rents from real property. In the case of many of the services that Congress intended to cover, it would be very difficult to allocate the services to particular tenants. Consistent with this intent, § 856(d)(7)(B) expressly applies on a property-by-property basis. Consequently, the one-percent limitation in that section is applied to aggregate amounts received with respect to a property.

Rev. Rul. 72–353, which makes a determination under § 856(d)(2)(A) on a lease-by-lease basis, is distinguishable. Section 856(d)(2)(A) relates to contingent rents determined by reference to any person's income or profits derived from a property. In contrast to amounts allocable to tenant services, the presence or absence of contingent rents can be determined on a lease-by-lease basis in all cases.

HOLDING

(1) In *Situation 1*, only the $9*x* attributable to the impermissible tenant services rendered to tenants of the guest apartments fails to qualify as rents from real property.

(2) In *Situation 2*, all $1,000*x* of income derived from Building P fails to qualify as rents from real property.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 72–353 is distinguished.

DRAFTING INFORMATION

The principal author of this revenue ruling is Eric E. Boody of the Office of Assistant Chief Counsel (Financial Institutions and Products). For further information regarding this revenue ruling contact Mr. Boody on (202) 622-3960 (not a toll-free call).

Section 6621.— Determination of Interest Rate

26 CFR 301.6621–1: Interest rate.

Interest rates; underpayments and overpayments. The rate of interest determined under section 6621 of the Code for the calendar quarter beginning January 1, 1999, will be 7 percent for overpayment (6 percent in the case of a corporation), 7 percent for underpayments, and 9 percent for large corporate underpayments. The rate of interest paid on the portion of a corporate overpayment exceeding $10,000 is 4.5 percent.

Rev. Rul. 98–61

Section 6621 of the Internal Revenue Code establishes the rates for interest on tax overpayments and tax underpayments. Under § 6621(a)(1), the overpayment rate beginning January 1, 1999, is the sum of the federal short-term rate plus 3 percentage points (2 percentage points in the case of a corporation), except the rate for the portion of a corporate overpayment of tax exceeding $10,000 for a taxable period is the sum of the federal short-term rate plus 0.5 of a percentage point for interest computations made after December 31, 1994. Under § 6621(a)(2), the underpayment rate is the sum of the federal short-term rate plus 3 percentage points.

Section 6621(c) provides that for purposes of interest payable under § 6601 on any large corporate underpayment, the underpayment rate under § 6621(a)(2) is determined by substituting "5 percentage points" for "3 percentage points." See § 6621(c) and § 301.6621–3 of the Regulations on Procedure and Administration for the definition of a large corporate underpayment and for the rules for determining the applicable date. Section 6621(c) and § 301.6621–3 are generally effective for periods after December 31, 1990.

Section 6621(b)(1) provides that the Secretary will determine the federal short-term rate for the first month in each calendar quarter.

Section 6621(b)(2)(A) provides that the federal short-term rate determined under § 6621(b)(1) for any month applies during the first calendar quarter beginning after such month.

Section 6621(b)(2)(B) provides that in determining the addition to tax under § 6654 for failure to pay estimated tax for any taxable year, the federal short-term rate that applies during the third month following such taxable year also applies during the first 15 days of the fourth month following such taxable year.

Section 6621(b)(3) provides that the federal short-term rate for any month is the federal short-term rate determined during such month by the Secretary in accordance with § 1274(d), rounded to the nearest full percent (or, if a multiple of 1/2 of 1 percent, the rate is increased to the next highest full percent).

Notice 88–59, 1988– C.B. 546, announced that, in determining the quarterly interest rates to be used for overpayments and underpayments of tax under § 6621, the Internal Revenue Service will use the federal short-term rate based on daily compounding because that rate is most consistent with § 6621 which, pursuant to § 6622, is subject to daily compounding.

Rounded to the nearest full percent, the federal short- term rate based on daily compounding determined during the month of October 1998 is 4 percent. Accordingly, an overpayment rate of 7 percent (6 percent in the case of a corporation) and an underpayment rate of 7 percent are established for the calendar quarter beginning January 1, 1999. The overpayment rate for the portion of a corporate overpayment exceeding $10,000 for the calendar quarter beginning January 1, 1999, is 4.5 percent. The underpayment rate for large corporate underpayments for the calendar quarter beginning January 1, 1999, is 9 percent. These rates apply to amounts bearing interest during that calendar quarter.

The 7 percent rate also applies to estimated tax underpayments for the first calendar quarter in 1999 and for the first 15 days in April 1999.

Interest factors for daily compound in-

terest for annual rates of 7 percent, 6 percent, 4.5 percent, and 9 percent are published in Tables 19, 17, 14, and 23 of Rev. Proc. 95–7, 1995–1 C.B. 556, 573, 571, 568, and 577.

Annual interest rates to be compounded daily pursuant to § 6622 that apply for prior periods are set forth in the tables accompanying this revenue ruling.

DRAFTING INFORMATION

The principal author of this revenue ruling is Raymond Bailey of the Office of Assistant Chief Counsel (Income Tax and Accounting). For further information regarding this revenue ruling, contact Mr. Bailey on (202) 622-6226 (not a toll-free call).

TABLE OF INTEREST RATES

PERIODS BEFORE JUL. 1, 1975 – PERIODS ENDING DEC. 31, 1986

OVERPAYMENTS AND UNDERPAYMENTS

PERIOD	RATE	In 1995–1 C.B. DAILY RATE TABLE
Before Jul. 1, 1975	6%	Table 2, pg. 557
Jul. 1, 1975—Jan. 31, 1976	9%	Table 4, pg. 559
Feb. 1, 1976—Jan. 31, 1978	7%	Table 3, pg. 558
Feb. 1, 1978—Jan. 31, 1980	6%	Table 2, pg. 557
Feb. 1, 1980—Jan. 31, 1982	12%	Table 5, pg. 560
Feb. 1, 1982—Dec. 31, 1982	20%	Table 6, pg. 560
Jan. 1, 1983—Jun. 30, 1983	16%	Table 37, pg. 591
Jul. 1, 1983—Dec. 31, 1983	11%	Table 27, pg. 581
Jan. 1, 1984—Jun. 30, 1984	11%	Table 75, pg. 629
Jul. 1, 1984—Dec. 31, 1984	11%	Table 75, pg. 629
Jan. 1, 1985—Jun. 30, 1985	13%	Table 31, pg. 585
Jul. 1, 1985—Dec. 31, 1985	11%	Table 27, pg. 581
Jan. 1, 1986—Jun. 30, 1986	10%	Table 25 pg. 579
Jul. 1, 1986—Dec. 31, 1986	9%	Table 23, pg. 577

TABLE OF INTEREST RATES

FROM JAN. 1, 1987 – Dec. 31, 1998

	OVERPAYMENTS			UNDERPAYMENTS		
		1995–1 C.B. RATE TABLE PG			1995–1 C.B. RATE TABLE PG	
Jan. 1, 1987—Mar. 31, 1987	8%	21	575	9%	23	577
Apr. 1, 1987—Jun. 30, 1987	8%	21	575	9%	23	577
Jul. 1, 1987—Sep. 30, 1987	8%	21	575	9%	23	577
Oct. 1, 1987—Dec. 31, 1987	9%	23	577	10%	25	579
Jan. 1, 1988—Mar. 31, 1988	10%	73	627	11%	75	629
Apr. 1, 1988—Jun. 30, 1988	9%	71	625	10%	73	627
Jul. 1, 1988—Sep. 30, 1988	9%	71	625	10%	73	627
Oct. 1, 1988—Dec. 31, 1988	10%	73	627	11%	75	629
Jan. 1, 1989—Mar. 31, 1989	10%	25	579	11%	27	581
Apr. 1, 1989—Jun. 30, 1989	11%	27	581	12%	29	583
Jul. 1, 1989—Sep. 30, 1989	11%	27	581	12%	29	583
Oct. 1, 1989—Dec. 31, 1989	10%	25	579	11%	27	581
Jan. 1, 1990—Mar. 31, 1990	10%	25	579	11%	27	581
Apr. 1, 1990—Jun. 30, 1990	10%	25	579	11%	27	581
Jul. 1, 1990—Sep. 30, 1990	10%	25	579	11%	27	581
Oct. 1, 1990—Dec. 31, 1990	10%	25	579	11%	27	581
Jan. 1, 1991—Mar. 31, 1991	10%	25	579	11%	27	581

TABLE OF INTEREST RATES (Continued)

FROM JAN. 1, 1987 – Dec. 31, 1998

	OVERPAYMENTS			UNDERPAYMENTS		
		1995–1 C.B. RATE TABLE PG			1995–1 C.B. RATE TABLE PG	
Apr. 1, 1991—Jun. 30, 1991	9%	23	577	10%	25	579
Jul. 1, 1991—Sep. 30, 1991	9%	23	577	10%	25	579
Oct. 1, 1991—Dec. 31, 1991	9%	23	577	10%	25	579
Jan. 1, 1992—Mar. 31, 1992	8%	69	623	9%	71	625
Apr. 1, 1992—Jun. 30, 1992	7%	67	621	8%	69	623
Jul. 1, 1992—Sep. 30, 1992	7%	67	621	8%	69	623
Oct. 1, 1992—Dec. 31, 1992	6%	65	619	7%	67	621
Jan. 1, 1993—Mar. 31, 1993	6%	17	571	7%	19	573
Apr. 1, 1993—Jun. 30, 1993	6%	17	571	7%	19	573
Jul. 1, 1993—Sep. 30, 1993	6%	17	571	7%	19	573
Oct. 1, 1993—Dec. 31, 1993	6%	17	571	7%	19	573
Jan. 1, 1994—Mar. 31, 1994	6%	17	571	7%	19	573
Apr. 1, 1994—Jun. 30, 1994	6%	17	571	7%	19	573
Jul. 1, 1994—Sep. 30, 1994	7%	19	573	8%	21	575
Oct. 1, 1994—Dec. 31, 1994	8%	21	575	9%	23	577
Jan. 1, 1995—Mar. 31, 1995	8%	21	575	9%	23	577
Apr. 1, 1995—Jun. 30, 1995	9%	23	577	10%	25	579
Jul. 1, 1995—Sep. 30, 1995	8%	21	575	9%	23	577
Oct. 1, 1995—Dec. 31, 1995	8%	21	575	9%	23	577
Jan. 1, 1996—Mar. 31, 1996	8%	69	623	9%	71	625
Apr. 1, 1996—Jun. 30, 1996	7%	67	621	8%	69	623
Jul. 1, 1996—Sep. 30, 1996	8%	69	623	9%	71	625
Oct. 1, 1996—Dec. 31, 1996	8%	69	623	9%	71	625
Jan. 1, 1997—Mar. 31, 1997	8%	21	575	9%	23	577
Apr. 1, 1997—Jun. 30, 1997	8%	21	575	9%	23	577
Jul. 1, 1997—Sep. 30, 1997	8%	21	575	9%	23	577
Oct. 1, 1997—Dec. 31, 1997	8%	21	575	9%	23	577
Jan. 1, 1998—Mar. 31, 1998	8%	21	575	9%	23	577
Apr. 1, 1998—Jun. 30, 1998	7%	19	573	8%	21	575
Jul. 1, 1998—Sep. 30, 1998	7%	19	573	8%	21	575
Oct. 1, 1998—Dec. 31, 1998	7%	19	573	8%	21	575

TABLE OF INTEREST RATES

FROM JANUARY 1, 1999 – PRESENT

NONCORPORATE OVERPAYMENTS AND UNDERPAYMENTS

	RATE	1995–1 C.B. TABLE	PAGE
Jan. 1, 1999—Mar. 31, 1999	7%	19	573

TABLE OF INTEREST RATES

FROM JANUARY. 1, 1999 – PRESENT
CORPORATE OVERPAYMENTS AND UNDERPAYMENTS

	OVERPAYMENTS			UNDERPAYMENTS		
	1995–1 C.B. RATE TABLE PG			1995–1 C.B. RATE TABLE PG		
Jan. 1, 1999—Mar. 31, 1999	6%	17	571	17%	19	573

TABLE OF INTEREST RATES FOR LARGE CORPORATE UNDERPAYMENTS

FROM JANUARY 1, 1991 – PRESENT

	1995–1 C.B.		
	RATE	TABLE	PG
Jan. 1, 1991—Mar. 31, 1991	13%	31	585
Apr. 1, 1991—Jun. 30, 1991	12%	29	583
Jul. 1, 1991—Sep. 30, 1991	12%	29	583
Oct. 1, 1991—Dec. 31, 1991	12%	29	583
Jan. 1, 1992—Mar. 31, 1992	11%	75	629
Apr. 1, 1992—Jun. 30, 1992	10%	73	627
Jul. 1, 1992—Sep. 30, 1992	10%	73	627
Oct. 1, 1992—Dec. 31, 1992	9%	71	625
Jan. 1, 1993—Mar. 31, 1993	9%	23	577
Apr. 1, 1993—Jun. 30, 1993	9%	23	577
Jul. 1, 1993—Sep. 30, 1993	9%	23	577
Oct. 1, 1993—Dec. 31, 1993	9%	23	577
Jan. 1, 1994—Mar. 31, 1994	9%	23	577
Apr. 1, 1994—Jun. 30, 1994	9%	23	577
Jul. 1, 1994—Sep. 30, 1994	10%	25	579
Oct. 1, 1994—Dec. 31, 1994	11%	27	581
Jan. 1, 1995—Mar. 31, 1995	11%	27	581
Apr. 1, 1995—Jun. 30, 1995	12%	29	583
Jul. 1, 1995—Sep. 30, 1995	11%	27	581
Oct. 1, 1995—Dec. 31, 1995	11%	27	581
Jan. 1, 1996—Mar. 31, 1996	11%	75	629
Apr. 1, 1996—Jun. 30, 1996	10%	73	627
Jul. 1, 1996—Sep. 30, 1996	11%	75	629
Oct. 1, 1996—Dec. 31, 1996	11%	75	629
Jan. 1, 1997—Mar. 31, 1997	11%	27	581
Apr. 1, 1997—Jun. 30, 1997	11%	27	581
Jul. 1, 1997—Sep. 30, 1997	11%	27	581
Oct. 1, 1997—Dec. 31, 1997	11%	27	581
Jan. 1, 1998—Mar. 31, 1998	11%	27	581
Apr. 1, 1998—Jun. 30, 1998	10%	25	579
Jul. 1, 1998—Sep. 30, 1998	10%	25	579
Oct. 1, 1998—Dec. 31, 1998	10%	25	579
Jan. 1, 1999—Mar. 31, 1999	9%	23	577

TABLE OF INTEREST RATES FOR CORPORATE
OVERPAYMENTS EXCEEDING $10,000

FROM JANUARY 1, 1995 – PRESENT

	RATE	1995–1 C.B. TABLE	PG
Jan. 1, 1995—Mar. 31, 1995	6.5%	18	572
Apr. 1, 1995—Jun. 30, 1995	7.5%	20	574
Jul. 1, 1995—Sep. 30, 1995	6.5%	18	572
Oct. 1, 1995—Dec. 31, 1995	6.5%	18	572
Jan. 1, 1996—Mar. 31, 1996	6.5%	66	620
Apr. 1, 1996—Jun. 30, 1996	5.5%	64	618
Jul. 1, 1996—Sep. 30, 1996	6.5%	66	620
Oct. 1, 1996—Dec. 31, 1996	6.5%	66	620
Jan. 1, 1997—Mar. 31, 1997	6.5%	18	572
Apr. 1, 1997—Jun. 30, 1997	6.5%	18	572
Jul. 1, 1997—Sep. 30, 1997	6.5%	18	572
Oct. 1, 1997—Dec. 31, 1997	6.5%	18	572
Jan. 1, 1998—Mar. 31, 1998	6.5%	18	572
Apr. 1, 1998—Jun. 30, 1998	5.5%	16	570
Jul. 1. 1998—Sep. 30, 1998	5.5%	16	570
Oct. 1, 1998—Dec. 31, 1998	5.5%	16	570
Jan. 1, 1999—Mar. 31, 1999	4.5%	14	568

Interim Guidance for Equitable Relief From Joint and Several Liability

Notice 98–61

SECTION 1. PURPOSE

The Treasury Department and the Internal Revenue Service are in the process of developing guidance for taxpayers seeking equitable relief from federal tax liability under § 6015(f) or 66(c) of the Internal Revenue Code. This notice provides interim guidance. The Treasury Department and the Service also request comments from the public to aid in the development of final guidance.

SECTION 2. BACKGROUND

.01 Section 3201(a) of the Internal Revenue Service Restructuring and Reform Act of 1998, Pub. L. No. 105–206, 112 Stat.742 (RRA), enacted new § 6015, which provides for relief in certain circumstances from joint and several liability for tax, interest, penalties and other amounts arising from a federal joint income tax return. (Any reference hereinafter to "tax" includes interest, penalties and other amounts.) Sections 6015(b) and 6015(c) specify two sets of circumstances under which relief is available. In addition, where relief is not available under § 6015(b) or 6015(c), § 6015(f) authorizes the Secretary to grant relief if, taking into account all the facts and circumstances, it is inequitable to hold a taxpayer liable for any unpaid tax or any deficiency. Section 3201(b) of RRA amended § 66(c) to add an equitable relief provision similar to § 6015(f). Section 66(c) applies to married individuals with community property income, and provides certain conditions under which an individual can be relieved from separate return liability for items of community income attributable to his or her spouse. The enactment of § 6015 and the amendment of § 66(c) are effective with respect to any liability for tax arising after July 22, 1998, and any liability for tax arising on or before July 22, 1998, that is unpaid on that date.

.02 Under § 6015(b), relief with respect to a deficiency will be granted to an individual if the following five conditions are met: (1) a joint return was made; (2) there was an understatement of tax attributable to erroneous items of the individual's spouse; (3) in signing the return, the individual did not know, and had no reason to know, that there was an understatement of tax; (4) taking into account all the facts and circumstances, it is inequitable to hold the individual liable for the deficiency in tax; and (5) the individual elects to apply for relief no later than two years after the date of the Service's first collection activity after July 22, 1998, with respect to the individual. If all five conditions would be met except for the fact that the individual did not know and had no reason to know of only a portion of the deficiency, then the individual can be granted relief to the extent that the liability is attributable to such portion.

.03 Relief with respect to a deficiency allocable to the other spouse will be granted to an individual under § 6015(c) if the following four conditions are met: (1) a joint return was made; (2) at the time relief is elected, the individual is no longer married to, is legally separated from, or has been living apart at all times for at least 12 months from his or her spouse or former spouse; (3) the individual elects to apply for relief no later than two years after the date of the Service's first collection activity after July 22, 1998, with respect to the individual; and (4) the liability remains unpaid at the time relief is elected. Relief under § 6015(c) is subject to several limitations. First, relief under § 6015(c) is not available if assets were transferred between the spouses as part of a fraudulent scheme. Second, if an individual has actual knowledge that an item on a return is incorrect, relief is not available to the extent any deficiency is attributable to such item. Third, relief will only be available to the extent that the liability exceeds the value of any disqualified assets transferred to the individual by the nonrequesting spouse. See § 6015(c)(4)(B).

.04 Section 6015 provides for relief only from joint and several liabilities arising from a joint return. If an individual signed a joint return involuntarily while under duress, the signature is not valid and a joint return was not made. The individual is not jointly and severally liable for liabilities arising from such a return and, therefore, § 6015 does not apply.

.05 Under both §§ 6015(b) and 6015(c), relief is limited to relief from liability for proposed or assessed deficiencies. Neither § 6015(b) nor § 6015(c) authorizes relief from liabilities that were properly reported on the return but not paid. However, equitable relief under § 6015(f) may be available for such liabilities. The legislative history of the RRA indicates that Congress intended the Secretary to exercise the equitable relief authority under § 6015(f) when a spouse "does not know, and had no reason to know, that funds intended for the payment of tax were instead taken by the other spouse for such other spouse's benefit." H.R. Conf. Rep. No. 599, 105th Cong., 2d Sess. 254 (1998). Congress also intended for the Secretary to exercise the equitable relief authority under § 6015(f) in other situations where, "taking into account all the facts and circumstances, it is inequitable to hold an individual liable for all or part of any unpaid tax or deficiency arising from a joint return." House Conf. Rep. No. 599 at 254.

SECTION 3. INTERIM GUIDANCE FOR EQUITABLE RELIEF UNDER SECTION 6015(f)

This notice provides interim guidance to taxpayers seeking equitable relief under § 6015(f) in three areas. First, section 3.01 of this notice provides threshold conditions that must be satisfied in order for an individual to be considered for relief under § 6015(f). Second, section 3.02 of this notice sets forth the circumstances in which relief under § 6015(f) will ordinarily be granted in the situation where an individual did not know, and had no reason to know, that funds intended for the payment of tax were instead taken by the spouse for the spouse's benefit. Third, for all other requests for relief under § 6015(f), and all requests for relief under § 66(c), section 3.03 of this notice provides a partial list of factors to be considered in determining whether it would be inequitable to hold an individual liable for a deficiency or unpaid liability.

.01 *Eligibility to be considered for eq-*

uitable relief. All the following threshold conditions must be met for an individual to be considered for relief under § 6015(f) from liability for tax. These threshold conditions apply to all requests for relief under § 6015(f) (*i.e.*, those relating to liabilities for deficiencies and those relating to liabilities that were properly reported on the return but not paid):

(1) The individual made a joint return for the taxable year for which relief is sought;

(2) Relief is not available to the individual under § 6015(b) or 6015(c);

(3) The individual applies for relief no later than two years after the date of the Service's first collection activity after July 22, 1998, with respect to the individual;

(4) Except as provided in the next sentence, the liability remains unpaid at the time relief is requested. An individual is eligible to be considered for relief in the form of a refund of liabilities for: (a) amounts paid on or after July 22, 1998, and on or before April 15, 1999; and (b) installment payments, made after July 22, 1998, pursuant to an installment agreement entered into with the Service and with respect to which an individual is not in default, that are made after the claim for relief is requested;

(5) No assets were transferred between the individuals filing the joint return as part of a fraudulent scheme by such individuals;

(6) There were no disqualified assets transferred to the individual by the nonrequesting spouse. If there were disqualified assets transferred to the individual by the nonrequesting spouse, relief will be available only to the extent that the liability exceeds the value of such disqualified assets. For this purpose, the term "disqualified asset" has the meaning given such term by § 6015(c)(4)(B); and

(7) The individual did not file the joint return with fraudulent intent.

An individual satisfying all the above threshold conditions may be relieved of the liability under § 6015(f) if, taking into account all the facts and circumstances, it is inequitable to hold the individual liable for all or part of a tax liability. See section 3.02 of this notice for circumstances under which relief will ordinarily be granted, and section 3.03 of this notice for factors used to determine whether to grant equitable relief.

.02 *Circumstances under which equitable relief will ordinarily be granted.* The following are the circumstances under which equitable relief from tax liability for a taxable year will ordinarily be granted to an individual requesting relief under § 6015(f):

(1) The liability reported on a joint return for such year was unpaid at the time such return was filed;

(2) At the time relief is requested, the individual is no longer married to, or is legally separated from, the spouse with whom such individual filed the joint return to which the request for relief relates, or has at no time during the 12-month period ending on the date relief is requested, been a member of the same household as the spouse with whom such joint return was filed;

(3) At the time the return was filed, the individual did not know, and had no reason to know, that the tax would not be paid. The individual must establish that it was reasonable for such individual to believe that the nonrequesting spouse would pay the reported liability. If an individual would otherwise qualify for relief under section 3.02 of this notice, except for the fact that the individual did not know, and had no reason to know, of only a portion of the unpaid liability, then the individual will be granted relief to the extent that the liability is attributable to such portion; and

(4) The individual would suffer undue hardship if relief from the liability were not granted. For this purpose, the term "undue hardship" has the meaning given to such term under § 1.6161–1(b) of the Income Tax Regulations.

Relief under section 3.02 of this notice is subject to the following limitations: (a) if the return is or has been adjusted to reflect an understatement of tax, relief will be available only to the extent of the liability shown on the return prior to any such adjustment; and (b) relief will only be available to the extent that the unpaid liability is attributable to the nonrequesting spouse.

.03 *Factors for determining whether to grant equitable relief.* Section 3.03 of this notice applies to married individuals filing separate returns in community property states who request relief under § 66(c), and individuals who meet the threshold conditions of section 3.01 of this notice but who do not qualify for relief under section 3.02 of this notice. Such individuals may qualify for relief from tax liability for a taxable year under § 6015(f) or 66(c) if, taking into account all the facts and circumstances, it is inequitable to hold the individual liable for the unpaid liability or deficiency. The following are partial lists of the positive and negative factors that will be taken into account in determining whether to grant equitable relief under § 6015(f) or 66(c). The list is not intended to be exhaustive.

(1) *Factors weighing in favor of relief:*

(a) *Marital status.* The individual requesting relief is separated (whether legally separated or living apart) or divorced from the nonrequesting spouse;

(b) *Hardship.* The individual requesting relief will suffer hardship if the relief is not granted, even if such hardship does not constitute undue hardship within the meaning of § 1.6161-1(b);

(c) *Abuse*. The individual requesting relief was abused by his or her spouse (but such abuse did not amount to duress); and

(d) *Spouse's legal obligation*. The nonrequesting spouse has a legal obligation pursuant to a divorce decree or agreement to pay the liability.

(2) *Factors weighing against relief:*

(a) *Attribution.* If any unpaid liability or item giving rise to a deficiency is attributable to the individual requesting relief, that is a factor weighing against relief from such unpaid liability or deficiency;

(b) *Knowledge, or reason to know.* An individual's knowledge or reason to know of an unpaid liability or deficiency is an extremely strong factor weighing against relief. Nonetheless, when the factors in favor of equitable relief are unusually strong, it may be appropriate to grant relief under § 6015(f) in limited situations where an individual knew or had reason to know of an unpaid liability, and in very limited situations where an individual knew or had reason to know of a deficiency; and

(c) *Significant benefit.* The individual requesting relief has significantly benefitted (beyond normal support) from the unpaid liability or items giving rise to the deficiency. See, for example, § 1.6013–5(b).

(d) *Individual's legal obligation.* The individual requesting relief has a legal obligation pursuant to a divorce decree or agreement to pay the liability.

SECTION 4. REQUEST FOR COMMENTS

The Treasury Department and the Service invite public comment on the matters addressed by this notice, particularly regarding the following specific topics: (1) the circumstances set forth in section 3.02 of this notice under which § 6015(f) relief will ordinarily be available; (2) the factors set forth in section 3.03 of this notice to be taken into account in determining whether § 6015(f) equitable relief may be available; (3) situations in which relief under § 6015(f) or 66(c) should be available even though an individual knew, or had reason to know of, a deficiency or unpaid liability; and (4) situations in which relief under § 6015(f) or 66(c) should be available even though the unpaid liability or item giving rise to the deficiency is attributable to the individual requesting relief. Written comments should be submitted by April 30, 1999, either to:

Internal Revenue Service
P.O. Box 7604
Ben Franklin Station
Washington, DC 20044
Attn: CC:DOM:CORP:R, Room 5228 (IT&A:Br4)

or electronically via:

http://www.irs.ustreas.gov/prod/tax_regs/comments.html

(the Service's Internet site).

SECTION 5. EFFECTIVE DATE

The interim guidance contained in this notice is effective on December 7, 1998, and may be relied upon until permanent guidance is issued. No inference should be made that the interim guidance contained in this notice will, or will not, be incorporated into the permanent guidance.

DRAFTING INFORMATION

The principal author of this notice is Bridget E. Finkenaur of the Office of Assistant Chief Counsel (Income Tax and Accounting). For further information regarding this notice, contact Ms. Finkenaur on (202) 622-4940 (not a toll-free call).

Notice 98–62

This Notice provides information about Internal Revenue Service procedures under section 6331(h) of the Internal Revenue Code of 1986.

The Taxpayer Relief Act of 1997 added section 6331(h) to the Code in order to provide for a continuous levy of up to 15 percent of any "specified payment due to or received by a taxpayer." I.R.C. § 6331(h)(1). Section 6331(h)(2) defines a specified payment as: any Federal payment other than a payment for which eligibility is based on income or assets (or both) of a payee; unemployment compensation; workmen's compensation; wages, salary, or other income to the extent they do not exceed minimum exemptions for an I.R.S. levy; supplemental security income for the aged, blind, and disabled under Social Security; state or local public welfare programs based on needs or income; and any annuity or pension under the Railroad Retirement Act or benefit under the Railroad Unemployment Insurance Act.

The Service has received questions as to whether levies are currently being served under section 6331(h). Section 6331(h) is effective for levies issued after August 5, 1997. Section 6010(f) of the Internal Revenue Service Restructuring and Reform Act of 1998 clarifies that the new continuous levy is an option for collection that is exercised at the Service's discretion. As of this date, the Service has no procedures for serving levies under section 6331(h), and no such levies have been issued. Procedures will be announced before any levies are issued under section 6331(h).

Because section 6331(h) does not identify a format for serving a continuous levy, there may be confusion as to whether the levy is a continuous levy under section 6331(h) or an ordinary form of levy under sections 6331(a) or 6331(e). When the continuous levy procedures are issued, they will require that any levy intended to be issued under section 6331(h) must be clearly identified, on the face of the levy, as a levy made pursuant to section 6331(h). Any levy that is not clearly identified, on the face of the levy, as a section 6331(h) levy will be treated as an ordinary levy under sections 6331(a) or 6331(e).

The principal author of this notice is Walter Ryan of the Office of Assistant Chief Counsel (General Litigation). For further information regarding this notice contact Mr. Ryan at 202-622-3610 (not a toll-free call).

Alternative Identifying Numbers for Income Tax Return Preparers

Notice 98–63

PURPOSE

This notice informs income tax return preparers of the Service's intention to develop a system of providing alternative identifying numbers for preparers, as authorized by § 3710 of the Internal Revenue Service Restructuring and Reform Act of 1998, Pub. L. No. 105–206, 112 Stat. 685 (the "Act"). Individual preparers are reminded of their continuing responsibility to furnish their social security numbers ("SSNs") on returns or claims for refund prepared by them.

LAW PRIOR TO AMENDMENT BY THE ACT

Section 6109(a)(4) of the Internal Revenue Code provides that any return or claim for refund prepared by an income tax return preparer must bear the identifying number of the preparer as required under regulations prescribed by the Secretary. Prior to its amendment by § 3710 of the Act, § 6109(a) of the Code provided that the identifying number of an individual preparer was that individual's SSN.

Section 1.6109–2 of the Income Tax Regulations provides that each return or claim for refund prepared by an income tax return preparer must bear the identifying number of the preparer, which, for an individual preparer, is that individual's SSN.

EFFECT OF THE ACT

Under § 6109(a), as amended by § 3710 of the Act, the identifying number required for a return preparer need not be the preparer's SSN. Instead, the Secretary may issue regulations providing alternatives to the SSN for purposes of identifying individual preparers. See § 6109(d).

To implement this change, the Service intends to develop a system for assigning alternative identifying numbers to individual preparers. These alternative identifying numbers are scheduled to be available for the filing season beginning January 1, 2000. The Secretary intends to amend § 1.6109–2 to allow individual preparers the option of electing alternative identifying numbers in lieu of their SSNs.

Until the alternative identifying numbers are available, § 1.6109–2 requires that individual preparers continue to furnish their SSNs as their identifying numbers. However, as provided by Rev. Rul. 78–317, 1978–2 C.B. 335, preparers may omit their SSNs from copies of returns furnished to taxpayers under § 6107(a).

The Service will continue to monitor returns and claims for refund for the presence of preparer SSNs. Income tax return preparers failing to furnish their SSNs on returns or claims for refund are subject to a penalty of $50 for each such failure, as provided by § 6695(c).

DRAFTING INFORMATION

The principal author of this notice is Andrew J. Keyso of the Office of the Assistant Chief Counsel (Income Tax and Accounting). Preparers may obtain updates on the status of the system for assigning alternative identifying numbers by calling (202) 622-4405 (not a toll-free call).

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26 CFR 601.204: Changes in accounting periods and in methods of accounting.
(Also Part I, §§ 162, 165, 166, 167, 168, 174, 197, 263, 263A, 446, 451, 454, 455, 461, 471, 472, 475, 481, 585, 1272, 1273, 1281, 1363; 1.165–2, 1.167(a)–11, 1.167(e)–1, 1.174–1, 1.174–3, 1.174–4, 1.263(a)–2, 1.263A–1, 1.263A–3, 1.446–1, 1.446–2, 1.454–1, 1.455–6, 1.461–4, 1.461–5, 1.471–1, 1.471–2, 1.471-3, 1.472–6, 1.472–8, 1.481–1, 1.481–4, 1.1272–1, 1.1273–1, 1.1273–2.)

Rev. Proc. 98-60

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SECTION 1. PURPOSE

This revenue procedure provides the procedures by which a taxpayer may obtain automatic consent to change the methods of accounting described in the APPENDIX of this revenue procedure. This revenue procedure clarifies, modifies, amplifies, and supersedes Rev. Proc. 97–37, 1997–2 C.B. 455. It also consolidates automatic consent procedures for changes in several methods of accounting that were published subsequent to the publication of Rev. Proc. 97–37, and provides new automatic consent procedures for changes in several other methods of accounting. A taxpayer complying with all the applicable provisions of this revenue procedure has obtained the consent of the Commissioner of Internal Revenue to change its method of accounting under § 446(e) of the Internal Revenue Code and the Income Tax Regulations thereunder.

SECTION 2. BACKGROUND AND CHANGES

.01 *Change in method of accounting defined.*

(1) Section 1.446–1(e)(2)(ii)(a) of the Income Tax Regulations provides that a change in method of accounting includes a change in the overall plan of accounting for gross income or deductions, or a change in the treatment of any material item. A material item is any item that involves the proper time for the inclusion of the item in income or the taking of the item as a deduction. In determining whether a taxpayer's accounting practice for an item involves timing, generally the relevant question is whether the practice permanently changes the amount of the taxpayer's lifetime income. If the practice does not permanently affect the taxpayer's lifetime income, but does or could change the taxable year in which income is reported, it involves timing and is therefore a method of accounting. *See* Rev. Proc. 91–31, 1991–1 C.B. 566.

(2) Although a method of accounting may exist under this definition without a pattern of consistent treatment of an item, a method of accounting is not adopted in most instances without consistent treatment. The treatment of a material item in the same way in determining the gross income or deductions in two or more consecutively filed tax returns (without regard to any change in status of the method as permissible or impermissible) represents consistent treatment of that item for purposes of § 1.446–1(e)(2)(ii)(a). If a taxpayer treats an item properly in the first return that reflects the item, however, it is not necessary for the taxpayer to treat the item consistently in two or more consecutive tax returns to have adopted a method of accounting. If a taxpayer has adopted a method of accounting under these rules, the taxpayer may not change the method by amending its prior income tax return(s). *See* Rev. Rul. 90–38, 1990–1 C.B. 57.

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

(4) A change in method of accounting does not include correction of mathematical or posting errors, or errors in the computation of tax liability (such as errors in computation of the foreign tax credit, net operating loss, percentage depletion, or investment credit). *See* § 1.446–1(e)(2)(ii)(b).

.02 *Securing permission to make a method change.* Sections 446(e) and 1.446-1(e) state that, except as otherwise provided, a taxpayer must secure the consent of the Commissioner before changing a method of accounting for federal income tax purposes. Section 1.446–1(e)(3)(i) requires that, in order to obtain the Commissioner's consent to a method change, a taxpayer must file a Form 3115, Application for Change in Accounting Method, during the taxable year in which the taxpayer wants to make the proposed change.

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

§ 481(a) adjustment or on a cut-off basis, and the § 481(a) adjustment period.

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

.05 *Method change with a § 481(a) adjustment.*

(1) *Need for adjustment.* Section 481(a) requires those adjustments necessary to prevent amounts from being duplicated or omitted to be taken into account when the taxpayer's taxable income is computed under a method of accounting different from the method used to compute taxable income for the preceding taxable year. When there is a change in method of accounting to which § 481(a) is applied, income for the taxable year preceding the year of change must be determined under the method of accounting that was then employed, and income for the year of change and the following taxable years must be determined under the new method of accounting as if the new method had always been used.

Example. A taxpayer that is not required to use inventories uses the overall cash receipts and disbursements method and changes to an overall accrual method. The taxpayer has $120,000 of income earned but not yet received (accounts receivable) and $100,000 of expenses incurred but not yet paid (accounts payable) as of the end of the taxable year preceding the year of change. A positive § 481(a) adjustment of $20,000 ($120,000 accounts receivable less $100,000 accounts payable) is required as a result of the change.

(2) *Adjustment period.* Section 481(c) and §§ 1.446–1(e)(3)(ii) and 1.481–4 provide that the adjustment required by § 481(a) may be taken into account in determining taxable income in the manner and subject to the conditions agreed to by the Commissioner and the taxpayer. Generally, in the absence of such an agreement, the § 481(a) adjustment is taken into account completely in the year of change, subject to § 481(b) which limits the amount of tax where the § 481(a) adjustment is substantial. However, under the Commissioner's authority in § 1.446–1(e)(3)(ii) to prescribe terms and conditions for changes in methods of accounting, this revenue procedure provides specific adjustment periods that are intended to achieve an appropriate balance between the goals of mitigating distortions of income that result from accounting method changes and providing appropriate incentives for voluntary compliance.

.06 *Method change using a cut-off method.* The Commissioner may determine that certain changes in methods of accounting will be made without a § 481(a) adjustment, using a "cut-off method." Under a cut-off method, only the items arising on or after the beginning of the year of change (or other operative date) are accounted for under the new method of accounting. Any items arising before the year of change (or other operative date) continue to be accounted for under the taxpayer's former method of accounting. *See,* for example, § 263A (which generally applies to costs incurred after December 31, 1986, for noninventory property), § 461(h) (which generally applies to amounts incurred on or after July 18, 1984), and § 1.446–3 (which applies to notional principal contracts entered into on or after December 13, 1993). Because no items are duplicated or omitted from income when a cut-off method is used to effect a change in accounting method, no § 481(a) adjustment is necessary.

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

.08 *Separate trades or businesses.*

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

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

.09 *Penalties.* Any otherwise applicable penalty for the failure of a taxpayer to change its method of accounting (for example, the accuracy-related penalty under § 6662 or the fraud penalty under § 6663) may be imposed if the taxpayer does not timely file a request to change a method of accounting. *See* § 446(f). Additionally, the taxpayer's return preparer may also be subject to the preparer penalty under § 6694. However, penalties will not be imposed when a taxpayer changes from an impermissible method of accounting to a permissible one by complying with all applicable provisions of this revenue procedure.

.10 Change made as part of an examination. Sections 446(b) and 1.446–1(b)(1) provide that if a taxpayer does not regularly employ a method of accounting that clearly reflects its income, the computation of taxable income must be made in a manner that, in the opinion of the Commissioner, does clearly reflect income. If a taxpayer under examination is not eligible to change a method of accounting under this revenue procedure, the change may be made by the district director. A change resulting in a positive § 481(a) adjustment will ordinarily be made in the earliest taxable year under examination with a one-year § 481(a) adjustment period.

.11 *Significant changes.* Significant changes to Rev. Proc. 97–37 include:

(1) Section 4.02(6) clarifies that the year of change is included within the five-year prohibition regarding prior changes;

(2) Section 6.02(2) clarifies that the automatic extension of 6 months from the due date of the return provided in § 301.9100-2 is applicable;

(3) Section 9.01 clarifies that the district director is to ascertain if a change in method of accounting was made in compliance with all the applicable provisions of this revenue procedure;

(4) Section 10.04 clarifies that an ap-

plication reviewed and changed by the national office is subject to review by the district director as provided in section 9 of this revenue procedure;

(5) Section 13.03 provides that the effective date of this revenue procedure is December 21, 1998, for applications or copies of applications filed with the national office under section 2.01 or 2.02 of the APPENDIX;

(6) Section 2.01 of the APPENDIX provides that this revenue procedure is the exclusive procedure for making that change, includes property for which excess depreciation was claimed, excludes property for which depreciation is determined under § 1.167(a)–11, and requires additional information for any public utility property;

(7) Section 2.02 of the APPENDIX requires additional information for any public utility property;

(8) Section 3.01 of the APPENDIX is modified to provide that the change does not apply to a taxpayer that wants to change to the capitalization method for costs of developing (or modifying) any package design that has an ascertainable useful life;

(9) Section 10.01 of the APPENDIX provides that a taxpayer is not required to file a Form 3115 to re-elect the LIFO inventory method after a period of five taxable years beginning with the year of change;

(10) Section 10.04 of the APPENDIX provides that a taxpayer wanting to make an IPIC change where a bulk bargain purchase previously occurred must first comply with *Hamilton Industries, Inc. v. Commissioner,* 97 T.C. 120 (1991), and compute a § 481(a) adjustment for the bargain purchase part of the change;

(11) The following changes in methods of accounting have been added to the APPENDIX of this revenue procedure:

(a) Section 1.02 of the APPENDIX regarding Year 2000 costs;

(b) Section 2A.01 of the APPENDIX regarding research and experimental expenditures;

(c) Section 3.02 of the APPENDIX regarding line pack gas and cushion gas;

(d) Section 5.04 of the APPENDIX regarding the Rule of 78s;

(e) Section 8.05 of the APPENDIX regarding cooperative advertising;

(f) Section 9.02 of the APPENDIX regarding estimating inventory shrinkage;

(g) Section 10A.01 of the APPENDIX regarding the mark-to-market method of accounting for a taxpayer's first taxable year ending after July 22, 1998; and

(h) Section 12.02 of the APPENDIX regarding pool of debt instruments for the taxpayer's first taxable year beginning after August 5, 1997.

SECTION 3. DEFINITIONS

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

.02 *Taxpayer.*

(1) *In general.* The term "taxpayer" has the same meaning as the term "person" defined in § 7701(a)(1) (rather than the meaning of the term "taxpayer" defined in § 7701(a)(14)).

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

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

.04 *Mailed.* The date of mailing will be determined under the rules of § 7502. For example, the date of mailing is the date of the U.S. postmark or the applicable date recorded or marked by a designated private delivery service. *See* Notice 98–47, 1998–37 I.R.B. 8.

.05 *Timely performance of acts.* The rules of § 7503 apply when the last day for the taxpayer's timely performance of any act (for example, filing an application or submitting additional information) falls on a Saturday, Sunday, or legal holiday. The performance of any act is timely if the act is performed on the next succeeding day that is not a Saturday, Sunday, or legal holiday.

.06 *Year of change.* The year of change is the taxable year for which a change in method of accounting is effective, that is, the first taxable year the new method is to be used, even if no affected items are taken into account for that year.

.07 *Section 481(a) adjustment period.* The § 481(a) adjustment period is the applicable number of taxable years for taking into account the § 481(a) adjustment required as a result of the change in method of accounting. The year of change is the first taxable year in the adjustment period and the § 481(a) adjustment is taken into account ratably over the number of taxable years in the adjustment period. The applicable adjustment periods are set forth in section 5.04 of this revenue procedure.

.08 *Under examination.*

(1) *In general.*

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

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

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

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

pires, or the date of the notice of claim disallowance.

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

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

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

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

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

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

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

.09 *Issue under consideration.*

(1) *Under examination.* A taxpayer's method of accounting for an item is an issue under consideration for the taxable years under examination if the taxpayer receives written notification (for example, by examination plan, information document request (IDR), or notification of proposed adjustments or income tax examination changes) from the examining agent(s) specifically citing the treatment of the item as an issue under consideration. For example, a taxpayer's method of pooling under the dollar-value, last-in, first-out (LIFO) inventory method is an issue under consideration as a result of an examination plan that identifies LIFO pooling as a matter to be examined, but it is not an issue under consideration as a result of an examination plan that merely identifies LIFO inventories as a matter to be examined. Similarly, a taxpayer's method of determining inventoriable costs under § 263A is an issue under consideration as a result of an IDR that requests documentation supporting the costs included in inventoriable costs, but it is not an issue under consideration as a result of an IDR that requests documentation supporting the amount of cost of goods sold reported on the return. The question of whether a method of accounting is an issue under consideration may be referred to the national office as a request for technical advice under the provisions of Rev. Proc. 98–2, 1998–1 I.R.B. 74 (or any successor).

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

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

.10 *Change within the LIFO inventory method.* A change within the LIFO inventory method is a change from one LIFO inventory method or sub-method to another LIFO inventory method or sub-method. A change within the LIFO inventory method does not include a change in method of accounting that could be made by a taxpayer that does not use the LIFO inventory method (for example, a method governed by § 471 or 263A).

SECTION 4. SCOPE

.01 *Applicability.* This revenue procedure applies to a taxpayer requesting the Commissioner's consent to change to a method of accounting described in the APPENDIX of this revenue procedure. This revenue procedure is the exclusive procedure for a taxpayer within its scope to obtain the Commissioner's consent.

.02 *Inapplicability.* Except as otherwise provided in the APPENDIX of this revenue procedure (see, for example, sections 4.01, 5.04, 8.05, 9.02, 10A.01, 12.01, and 12.02 of the APPENDIX of this revenue procedure), this revenue procedure does not apply in the following situations:

(1) *Under examination.* If, on the date the taxpayer would otherwise file a copy of the application with the national office, the taxpayer is under examination (as provided in section 3.08 of this revenue procedure), except as provided in sections 6.03(2) (90-day window), 6.03(3) (120-day window), and 6.03(4) (district director consent) of this revenue procedure;

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

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

(4) *Consolidated group member.* A corporation that is (or was formerly) a member of a consolidated group is under examination, before an appeals office, or before a federal court (for purposes of

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

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

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

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

.03 *Nonautomatic changes.* If a taxpayer is precluded by other than sections 4.02(1) through 4.02(5) of this revenue procedure from using this revenue procedure to make a change in method of accounting, the taxpayer requesting such a change must file a Form 3115 with the Commissioner in accordance with the requirements of § 1.446–1(e)(3)(i) and Rev. Proc. 97–27, 1997–1 C.B. 680 (or any other applicable Code, regulation, or administrative provision).

SECTION 5. TERMS AND CONDITIONS OF CHANGE

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

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

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

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

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

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

Example 1. A calendar year taxpayer received permission to change an accounting method beginning with the 1998 calendar year. The § 481(a) adjustment is $30,000 and the adjustment period is four taxable years. The taxpayer subsequently receives permission to change its annual accounting period to September 30, effective for the taxable year ending September 30, 1999. The taxpayer must include $7,500 of the § 481(a) adjustment in gross income for the short period from January 1, 1999, through September 30, 1999.

Example 2. Corporation *X*, a calendar year taxpayer, received permission to change an accounting method beginning with the 1998 calendar year. The § 481(a) adjustment is $30,000 and the adjustment period is four taxable years. On July 1, 2000, Corporation *Z* acquires Corporation *X* in a transaction to which § 381(a) applies. Corporation *Z* is a calendar year taxpayer that uses the same method of accounting to which Corporation *X* changed in 1998. Corporation *X* must include $7,500 of the § 481(a) adjustment in gross income for its short period income tax return for January 1, 2000, through June 30, 2000. In addition, Corporation *Z* must include $7,500 of the § 481(a) adjustment in gross income in its income tax return for calendar year 2000.

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

(a) *De minimis rule.* A taxpayer may elect to use a one-year adjustment period in lieu of the § 481(a) adjustment period otherwise provided by this revenue procedure if the entire § 481(a) adjustment is less than $25,000 (either positive or negative). A taxpayer makes an election under this *de minimis* rule by so indicating on the application. For example, for a taxpayer filing a Form 3115, the taxpayer must complete the appropriate line on the Form 3115 to elect this *de minimis* rule.

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

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

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

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

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

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

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

(D) a division of a corporation ceases to operate the trade or busi-

ness to which the § 481(a) adjustment relates; or

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

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

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

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

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

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

.05 *NOL carryback limitation for taxpayer subject to criminal investigation.* Generally, no portion of any net operating loss that is attributable to a negative § 481(a) adjustment may be carried back to a taxable year prior to the year of change that is the subject of any pending or future criminal investigation or proceeding concerning (1) directly or indirectly, any issue relating to the taxpayer's federal tax liability, or (2) the possibility of false or fraudulent statements made by the taxpayer with respect to any issue relating to its federal tax liability.

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

SECTION 6. GENERAL APPLICATION PROCEDURES

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

.02 *Filing requirements.*

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

(2) *Timely duplicate filing requirement.*

(a) *In general.* A taxpayer changing a method of accounting pursuant to this revenue procedure must complete and file an application in duplicate. Except as otherwise provided in the APPENDIX of this revenue procedure (see, for example, section 12.02 of the APPENDIX of this revenue procedure), the original must be attached to the taxpayer's timely filed (including extensions) original federal income tax return for the year of change, and a copy of the application must be filed with the national office (see section 6.02(6) of this revenue procedure for the address) no earlier than the first day of the year of change and no later than when the original is filed with the federal income tax return for the year of change.

(b) *Limited relief for late application.*

(i) *Automatic extension.* An automatic extension of 6 months from the due date of the return for the year of change (excluding extensions) is granted

to file an application, provided the taxpayer (A) timely filed (including extensions) its federal income tax return for the year of change, (B) files an amended return within the 6-month extension period in a manner that is consistent with the new method of accounting, (C) attaches the original application to the amended return, (D) files a copy of the application with the national office no later than when the original is filed with the amended return, and (E) writes at the top of the application "FILED PURSUANT TO § 301.9100–2."

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

(3) *Label.*

(a) In order to assist in processing an application under this revenue procedure, the section of the APPENDIX of this revenue procedure describing the specific change in method of accounting should be included in the application. For example, a phrase such as "Section 1.01 of the APPENDIX of Rev. Proc. 98-60" should be included on the appropriate line on the Form 3115.

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

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

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

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

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

(6) *Where to file copy.*

(a) For a taxpayer other than an exempt organization, the copy of the application must be addressed to the Commissioner of Internal Revenue, Attention: CC:DOM:IT&A (Automatic Rulings Branch), P.O. Box 7604, Benjamin Franklin Station, Washington, D.C. 20044 (or, in the case of a designated private delivery service: Commissioner of Internal Revenue, Attention: CC:DOM:IT&A (Automatic Rulings Branch), 1111 Constitution Avenue, NW, Washington, D.C. 20224).

(b) For an exempt organization, the copy of the application must be addressed to the Assistant Commissioner (Employee Plans and Exempt Organizations), Attention: E:EO, P.O. Box 120, Benjamin Franklin Station, Washington, D.C. 20044 (or, in the case of a designated private delivery service: Assistant Commissioner (Employee Plans and Exempt Organizations), Attention: E:EO, 1111 Constitution Avenue, NW, Washington, D.C. 20224).

(c) The copy of the application may also be hand delivered:

(i) To the drop box at the 12th Street entrance of 1111 Constitution Avenue, NW, Washington, D.C. No receipt will be given at the drop box. For a taxpayer other than an exempt organization, the copy of the application must be addressed to the Commissioner of Internal Revenue, Attention: CC:DOM:IT&A (Automatic Rulings Branch), 1111 Constitution Avenue, NW, Washington, D.C. 20224. For an exempt organization, the copy of the application must be addressed to the Assistant Commissioner (Employee Plans and Exempt Organizations), Attention: E:EO, 1111 Constitution Avenue, NW, Washington, D.C. 20224; or

(ii) Between the hours of 8:15 a.m. and 5:00 p.m., to the courier's desk at the main entrance of 1111 Constitution Avenue, NW, Washington, D.C. A receipt will be given at the courier's desk. For a taxpayer other than an exempt organization, the copy of the application must be addressed to the Commissioner of Internal Revenue, Attention: CC:DOM:IT&A (Automatic Rulings Branch), 1111 Constitution Avenue, NW, Washington, D.C. 20224. For an exempt organization, the copy of the application must be addressed to the Assistant Commissioner (Employee Plans and Exempt Organizations), Attention: E:EO, 1111 Constitution Avenue, NW, Washington, D.C. 20224

(7) *No user fee.* A user fee is not required for an application filed under this revenue procedure, and, except as provided in section 6.02(6)(c)(ii) of this revenue procedure, the receipt of an application filed under this revenue procedure will not be acknowledged.

(8) *Single application for certain consolidated groups.* A parent corporation may file a single application to change an identical method of accounting on behalf of more than one member of a consolidated group. To qualify, the taxpayers in the consolidated group must be members of the same affiliated group under § 1504(a) that join in the filing of a consolidated tax return, and they must be changing from the identical present method of accounting to the identical proposed method of accounting. All aspects of the change in method of accounting, including the present and proposed methods, the underlying facts, and the authority for the change, must be identical, except for the § 481(a) adjustment. *See*

section 15.07(3) of Rev. Proc. 98–1, 1998–1 I.R.B. at 54 (or any successor), for the information required to be submitted with the application.

.03 *Taxpayer under examination.*

(1) *In general.* Except as otherwise provided in the APPENDIX of this revenue procedure (see, for example, sections 4.01, 5.04, 8.05, 9.02, 10A.01, 12.01, and 12.02 of the APPENDIX of this revenue procedure), a taxpayer that is under examination may file an application to change a method of accounting under section 6 of this revenue procedure only if the taxpayer is within the provisions of section 6.03(2) (90-day window), 6.03(3) (120-day window), or 6.03(4) (district director consent) of this revenue procedure. A taxpayer that files an application beyond the time periods provided in the 90-day and 120-day windows is not eligible for the automatic extension of time and will not be granted an extension of time to file under § 301.9100, except in unusual and compelling circumstances.

(2) *90-day window period.*

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

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

(3) *120-day window period.*

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

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

(4) *Consent of district director.*

(a) A taxpayer under examination may change its method of accounting under this revenue procedure if the district director consents to the change. The district director will consent to the change unless, in the opinion of the district director, the method of accounting to be changed would ordinarily be included as an item of adjustment in the year(s) for which the taxpayer is under examination. For example, the district director will consent to a change from a clearly permissible method of accounting. The district director will also consent to a change from an impermissible method of accounting where the impermissible method was adopted subsequent to the years under examination. The question of whether the method of accounting from which the taxpayer is changing is permissible or was adopted subsequent to the years under examination may be referred to the national office as a request for technical advice under the provisions of Rev. Proc. 98–2 (or any successor).

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

.04 *Taxpayer before an appeals office.* Except as otherwise provided in the APPENDIX of this revenue procedure (see, for example, sections 4.01, 5.04, 8.05, 9.02, 10A.01, 12.01, and 12.02 of the APPENDIX of this revenue procedure), a taxpayer that is before an appeals office must attach to the application a separate statement signed by the taxpayer certifying that, to the best of the taxpayer's knowledge, the same method of accounting is not an issue under consideration by the appeals office. The taxpayer must provide a copy of the application to the appeals officer at the same time it files a copy of the application with the national office. The application must contain the name and telephone number of the appeals officer.

.05 *Taxpayer before a federal court.* Except as otherwise provided in the APPENDIX of this revenue procedure (see, for example, sections 4.01, 5.04, 8.05, 9.02, 10A.01, 12.01, and 12.02 of the APPENDIX of this revenue procedure), a taxpayer that is before a federal court must attach to the application a separate statement signed by the taxpayer certifying that, to the best of the taxpayer's knowledge, the same method of accounting is not an issue under consideration by the federal court. The taxpayer must provide a copy of the application to the counsel for the government at the same time it files a copy of the application with the national office. The application must contain the name and telephone number of the counsel for the government.

.06 *Compliance with provisions.* If a taxpayer to which this revenue procedure applies changes to a method of accounting without complying with all the applicable provisions of this revenue procedure (for example, the taxpayer changes to a method of accounting that varies from the applicable accounting method described in this revenue procedure or the taxpayer is outside the scope of this revenue procedure), the taxpayer has initiated a change

in method of accounting without obtaining the consent of the Commissioner as required by § 446(e). Upon examination, a taxpayer that has initiated an unauthorized change in method of accounting may be denied the change. Alternatively, such a taxpayer may be required to effect the change in an earlier or later taxable year and may be denied the benefit of spreading the § 481(a) adjustment over the number of taxable years otherwise prescribed by this revenue procedure.

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

.01 *In general.* Except as provided in section 7.02 or the APPENDIX of this revenue procedure, when a taxpayer timely files a copy of the application with the national office in compliance with all the applicable provisions of this revenue procedure, the Service will not require the taxpayer to change its method of accounting for the same item for a taxable year prior to the year of change.

.02 *Exceptions.*

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

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

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

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

SECTION 8. EFFECT OF CONSENT

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

(1) the enactment of legislation;

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

(3) the issuance of temporary or final regulations;

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

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

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

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

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

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

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

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

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

SECTION 9. REVIEW BY DISTRICT DIRECTOR

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

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

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

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

The district director will also ascertain whether:

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

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

.02 *National office consideration.* If the district director recommends that a change in method of accounting (other than the § 481(a) adjustment) made in compliance with all the applicable provisions of this revenue procedure should be modified or revoked, the district director will forward the matter to the national office for consideration before any further action is taken. Such a referral to the national office will be treated as a request for technical advice, and the provisions of Rev. Proc. 98–2 (or any successor) will be followed.

SECTION 10. REVIEW BY NATIONAL OFFICE

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

.02 *Incomplete application—21 day rule.* If the Service reviews an application and determines that the application is not properly completed in accordance with the instructions of the Form 3115 or the provisions of this revenue procedure, or if supplemental information is needed, the Service will notify the taxpayer. The notification will specify the information that needs to be provided, and the taxpayer will be permitted 21 days from the date of the notification to furnish the necessary information. The Service reserves the right to impose shorter reply periods if subsequent requests for additional information are made. An extension of the 21-day period to furnish information, not to exceed 15 days, may be granted to a taxpayer. A request for an extension of the 21-day period must be made in writing and submitted within the 21-day period. If the extension request is denied, there is no right of appeal.

.03 *Conference in the national office.* If the national office tentatively determines that the taxpayer has changed its method of accounting without complying with all the applicable provisions of this revenue procedure (for example, the taxpayer changed to a method of accounting that varies from the applicable accounting method described in this revenue procedure or the taxpayer is outside the scope of this revenue procedure), the national office will notify the taxpayer of its tentative adverse determination and will offer the taxpayer a conference of right, if the taxpayer has requested a conference. For conference procedures for taxpayers other than exempt organizations, see section 11 of Rev. Proc. 98–1 (or any successor). For conference procedures for exempt organizations, see section 12 of Rev. Proc. 98–4, 1998–1 I.R.B. 113 (or any successor).

.04 *National office determination.*

(1) *Consent not granted.* Except as provided in section 10.04(2) of this revenue procedure, if the national office determines that a taxpayer has changed its method of accounting without complying with all the applicable provisions of this revenue procedure, the national office will notify the taxpayer that consent to make the change in method of accounting is not granted. See section 6.06 of this revenue procedure.

(2) *Application changed.* If the national office determines that a taxpayer has changed its method of accounting without complying with all the applicable provisions of this revenue procedure, the national office, in its discretion, may allow the taxpayer (a) to make appropriate adjustments to conform its change in method of accounting to the applicable provisions of this revenue procedure, and (b) to make conforming amendments to any federal income tax returns filed for the year of change and subsequent taxable years. Any application changed under section 10.04(2) of this revenue procedure is subject to review by the district director as provided in section 9 of this revenue procedure.

SECTION 11. APPLICABILITY OF REV. PROCS. 98–1 AND 98–4

Rev. Procs. 98–1 and 98–4 (or any successors) are applicable to applications filed under this revenue procedure, unless specifically excluded or overridden by other published guidance (including the special procedures in this document).

SECTION 12. INQUIRIES

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

SECTION 13. EFFECTIVE DATE

.01 *In general.* Except as provided in sections 13.02 and 13.03 of this revenue procedure, this revenue procedure is effective for taxable years ending on or after December 21, 1998. The Service will return any application that is filed on or after December 21, 1998, if the application is filed with the national office pursuant to the Code, regulations, or administrative guidance other than this revenue procedure and the change in method of accounting is within the scope of this revenue procedure.

.02 *Transition rules.* If a taxpayer filed an application or ruling request with the national office to make a change in method of accounting authorized by this revenue procedure, and the application or ruling request is pending with the national office on December 21, 1998, the taxpayer may make the change under this revenue procedure. However, the national office will process the application or ruling request in accordance with the authority under which it was filed, unless prior to the later of February 1, 1999, or the issuance of the letter ruling granting or denying consent to the change, the taxpayer notifies the national office that it wants to make the change under this revenue procedure. If the taxpayer timely notifies the national office that it wants to make the method change under this revenue procedure, the national office will require the taxpayer to make appropriate modifications to the application or ruling request to comply with the applicable provisions of this revenue procedure. In addition, any user fee that was submitted with the application or ruling request will be returned to the taxpayer.

.03 *Special rules.*

(1) *Change in method of accounting for depreciation.* For a change in method of accounting described in section 2.01 or 2.02 of the APPENDIX of this revenue procedure, this revenue procedure is effective for applications or copies of applications filed with the national office on or after December 21, 1998.

(2) *Change in method of accounting to discontinue the mark-to-market method of accounting.* For a change in method of accounting described in section 10A.01 of the APPENDIX of this revenue procedure, this revenue procedure is effective for the taxpayer's first taxable year ending after July 22, 1998.

(3) *Change in method of accounting for a pool of debt instruments.* For a change in method of accounting described in section 12.02 of the APPENDIX of this revenue procedure, this revenue procedure is effective for the taxpayer's first taxable year beginning after August 5, 1997.

SECTION 14. EFFECT ON OTHER DOCUMENTS

.01 Rev. Proc. 97–37, is clarified, modified, amplified, and superseded.

.02 Rev. Rul. 98–39, 1998–33 I.R.B. 4 (see section 8.05 of the APPENDIX of this revenue procedure regarding cooperative advertising), is modified.

SECTION 15. PAPERWORK REDUCTION ACT

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

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

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

The estimated total annual reporting and/or recordkeeping burden is 15,514 hours.

The estimated annual burden per respondent/recordkeeper varies from ⅙ hour to 8½ hours, depending on individual circumstances, with an estimated average of 1½ hours. The estimated number of respondents is 13,500.

The estimated annual frequency of responses is on occasion.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

DRAFTING INFORMATION

The principal author of this revenue procedure is Dwight N. Mersereau of the Office of Assistant Chief Counsel (Income Tax and Accounting). For further information regarding this revenue procedure, contact Mr. Mersereau on (202) 622-4970 (not a toll-free call). For further information regarding the APPENDIX of this revenue procedure contact the following individuals: (1) for changes in methods of accounting under sections 2.01 and 2.02 of the APPENDIX of this revenue procedure, Peter Friedman of the Office of Assistant Chief Counsel (Passthroughs and Special Industries) on (202) 622-3110 (not a toll-free call); (2) for changes in methods of accounting under section 2A.01 of the APPENDIX of this revenue procedure, Leslie H. Finlow of the Office of Assistant Chief Counsel (Passthroughs and Special Industries) on (202) 622-3120 (not a toll free call); (3) for changes in methods of accounting under sections 5.04, 6, 12, and 13 of the APPENDIX of this revenue procedure, William Blanchard of the Office of Assistant Chief Counsel (Financial Institutions and Products) on (202) 622-3950 (not a toll-free call); (4) for changes in methods of accounting under section 10A.01 of the APPENDIX of this revenue procedure, Pamela Lew of the Office of Assistant Chief Counsel (Financial Institutions and Products) on (202) 622-3950 (not a toll-free call); (5) for changes in methods of accounting under section 11 of the APPENDIX of this revenue procedure, Craig R. Wojay of the Office of Assistant Chief Counsel (Financial Institutions and Products) on (202) 622-3920 (not a toll-free call); and (6) for all other sections, Mr. Mersereau on (202) 622-4970 (not a toll-free call).

APPENDIX

CHANGES IN METHODS OF ACCOUNTING TO WHICH THIS REVENUE PROCEDURE APPLIES

SECTION 1. TRADE OR BUSINESS EXPENSES (§ 162)

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

.02 *Year 2000 costs — Description of change and scope.* This change applies to a taxpayer that wants to change its method of accounting for Year 2000 costs (as defined in Rev. Proc. 97–50, 1997–2 C.B. 525) to conform to the method described in section 3 of Rev. Proc. 97–50. Section 3 of Rev. Proc. 97–50 provides that Year 2000 costs fall within the purview of Rev. Proc. 69–21, 1969–2 C.B. 303, and that the Service will not disturb a taxpayer's treatment of its Year 2000 costs as deductible expenses or capital expenditures if the taxpayer treats these costs in accordance with Rev. Proc. 69–21.

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

.01 *Impermissible to permissible method of accounting for depreciation or amortization.*

(1) *Description of change.*

(a) This change applies to a taxpayer that wants to change from an impermissible method of accounting for depreciation or amortization (depreciation) under which the taxpayer did not claim the depreciation allowable, to a permissible method of accounting for depreciation under which the taxpayer will claim the depreciation allowable.

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

(2) *Scope.*

(a) *Applicability.* This change applies to any taxpayer that has used an impermissible method of accounting for depreciation in at least the two taxable years immediately preceding the year of change, and is changing that accounting method to a permissible method of accounting for depreciation, for any item of property:

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

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

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

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

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

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

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

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

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

(vi) any property for which a taxpayer is revoking a timely valid election, or making a late election, under § 167, 168, former § 168, or § 13261(g)-(2) or (3) of the Revenue Reconciliation Act of 1993 (1993 Act), 1993–3 C.B. 1, 128 (relating to amortizable § 197 intangibles). A taxpayer may request consent to revoke or make the election by submitting a request for a letter ruling under Rev. Proc. 98–1, 1998–1 I.R.B. 7 (or any successor);

(vii) any property subject to § 167 (other than § 167(f), regarding certain property excluded from § 197), for which a taxpayer is changing only the estimated useful life of the property. A change in the estimated useful life of property for

which depreciation is determined under § 167 (other than § 167(f)) must be made prospectively (*see*, for example, § 1.167(b)–2(c)). (In contrast, section 2.01 of this APPENDIX generally applies to a change in the recovery period of property for which depreciation is determined under § 168 or former § 168);

(viii) any depreciable property that changes use but continues to be owned by the same taxpayer (see, for example, § 168(i)(5));

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

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

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

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

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

(xii) any change in method of accounting involving both a change from treating the cost or other basis of the property as nondepreciable property to treating the cost or other basis of the property as depreciable property and the adoption of a method of accounting for depreciation requiring an election under § 167, 168, former § 168, or § 13261(g)(2) or (3) of the 1993 Act (for example, a change in the treatment of the space consumed in landfills placed in service in 1990 from nondepreciable to depreciable property (assuming section 2.01(2)(c)(xiii) of the APPENDIX does not apply) and the making of an election under § 168(f)(1) to depreciate this property under the unit-of-production method of depreciation under § 167);

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

(A) a change in inventory costs (for example, when property is reclassified from inventory property to depreciable property, or vice versa) (but see section 3.02 of this APPENDIX for making a change from inventory property to depreciable property for unrecoverable line pack gas or unrecoverable cushion gas); or

(B) a change in the character of a transaction from sale to lease, or vice versa (but see section 2.03 of this APPENDIX for making this change); or

(xiv) a change from determining depreciation under § 168 to determining depreciation under former § 168 for any property subject to the transition rules in § 203(b) or 204(a) of the Tax Reform Act of 1986, 1986–3 (Vol. 1) C.B. 1, 60–80.

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

(a) Permissible depreciation method. A taxpayer must change to a permissible method of accounting for depreciation for the item of property. This method is the same method that determines the depreciation allowable for the item of property (as provided in section 2.01(6) of this APPENDIX).

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

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

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

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

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

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

(vi) if any item of property is public utility property within the meaning of § 168(i)(10) or former § 167(l)(3)(A), as applicable, a statement providing that the taxpayer agrees to the following additional terms and conditions:

(A) a normalization method of accounting (within the meaning of former § 167(l)(3)(G), former § 168(e)-(3)(B), or § 168(i)(9), as applicable) will be used for the public utility property subject to the application;

(B) as of the beginning of the year of change, the taxpayer will adjust its deferred tax reserve account or similar reserve account in the taxpayer's regulatory books of account by the amount of the deferral of federal income tax liability associated with the § 481(a) adjustment applicable to the public utility property subject to the application; and

(C) within 30 calendar days of filing the federal income tax return for the year of change, the taxpayer will provide a copy of the completed application to any regulatory body having jurisdiction over the public utility property subject to the application;

(vii) if the taxpayer is changing

the classification of an item of § 1250 property placed in service after August 19, 1996, to a retail motor fuels outlet under § 168(e)(3)(E)(iii), a statement containing the following representation: "For purposes of § 168(e)(3)(E)(iii) of the Internal Revenue Code, the taxpayer represents that (A) 50 percent or more of the gross revenue generated from the item of § 1250 property is from the sale of petroleum products (not including gross revenue from related services, such as the labor cost of oil changes and gross revenue from the sale of nonpetroleum products such as tires and oil filters), (B) 50 percent or more of the floor space in the item of property is devoted to the sale of petroleum products (not including floor space devoted to related services, such as oil changes and floor space devoted to nonpetroleum products such as tires and oil filters), or (C) the item of § 1250 property is 1,400 square feet or less."; and

(viii) if the taxpayer is changing the classification of an item of property from § 1250 property to § 1245 property under § 168 or former § 168, a statement of the facts and law supporting the new § 1245 property classification, and a statement containing the following representation: "Each item of property that is the subject of the application filed under section 2.01 of the APPENDIX of Rev. Proc. 98-60 for the year of change beginning [Insert the date], and that is reclassified from [Insert, as appropriate: nonresidential real property, residential rental property, 19-year real property, 18-year real property, or 15-year real property] to an asset class of [Insert, as appropriate, either: Rev. Proc. 87–56, 1987–2 C.B. 674, or Rev. Proc. 83–35, 1983–1 C.B. 745] that does not explicitly include § 1250 property, is § 1245 property for depreciation purposes."

(4) *Section 481(a) adjustment.* Because the adjusted basis of the property is changed as a result of a method change made under section 2.01 of this APPENDIX (see section 2.01(5) of this APPENDIX), items are duplicated or omitted. Accordingly, this change is made with a § 481(a) adjustment. This adjustment may result in either a negative § 481(a) adjustment (a decrease in taxable income) or a positive § 481(a) adjustment (an increase in taxable income). This § 481(a) adjustment equals the difference between the total amount of depreciation taken into account in computing taxable income for the property under the taxpayer's former method of accounting, and the total amount of depreciation allowable for the property under the taxpayer's new method of accounting (as determined under section 2.01(6) of this APPENDIX), for open and closed years prior to the year of change. However, the amount of the § 481(a) adjustment must be adjusted to account for the proper amount of the depreciation allowable that is required to be capitalized under any provision of the Code (for example, § 263A) at the beginning of the year of change.

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

(6) *Meaning of depreciation allowable.*

(a) *In general.* Section 2.01(6) of this APPENDIX provides the amount of the depreciation allowable, determined under § 167, 168, 197, or former § 168. This amount, however, may be limited by other provisions of the Code (for example, § 280F).

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

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

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

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

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

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

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

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

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

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

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

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

(1) *Description of change.* This change applies to a taxpayer that wants to change from a permissible method of accounting for depreciation under § 167 to another permissible method of accounting for depreciation under § 167. Pursuant to §§ 1.167(a)–7(a) and (c), a taxpayer may account for depreciable property either by treating each individual asset as an account or by combining two or more assets in a single account and, for each account,

depreciation allowances are computed separately.

(2) *Scope.*

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

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

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

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

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

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

(iii) any intangible property;

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

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

(vi) any property for which depreciation is determined under § 168 or § 168 prior to its amendment in 1986 (former § 168);

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

(d) *Public utility property*. If any item of property is public utility property within the meaning of former § 167(l)(3)(A), the taxpayer must attach to the application a statement providing that the taxpayer agrees to the following additional terms and conditions:

(i) a normalization method of accounting within the meaning of former § 167(l)(3)(G) will be used for the public utility property subject to the application; and

(ii) within 30 calendar days of filing the federal income tax return for the year of change, the taxpayer will provide a copy of the completed application to any regulatory body having jurisdiction over the public utility property subject to the application.

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

.03 *Sale or lease transactions.*

(1) *Description of change and scope.*

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

(i) improperly treating property as sold by the taxpayer to properly treating property as leased by the taxpayer;

(ii) improperly treating property as leased by the taxpayer to properly treating property as sold by the taxpayer;

(iii) improperly treating property as purchased by the taxpayer to properly treating property as leased by the taxpayer; and

(iv) improperly treating property as leased by the taxpayer to properly treating property as purchased by the taxpayer.

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

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

(ii) a taxpayer that holds assets for sale or lease, if any asset so held is not the subject of a sale or lease transaction as of the beginning of the year of change.

(2) *Manner of making the change.*

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

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

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

SECTION 2A. RESEARCH AND EXPERIMENTAL EXPENDITURES (§ 174)

.01 *Changes to a different method or different amortization period.*

(1) *Description of change.*

(a) This change applies to a taxpayer that wants to change the treatment of expenditures that qualify as research and experimental expenditures under § 174.

(b) Section 174 and the regulations thereunder provide the specific rules for changing a method of accounting under § 174 for research and experimental expenditures. Under § 174, a taxpayer may treat research and experimental expenditures that are paid or incurred by the taxpayer during the taxable year in connection with the taxpayer's trade or business as expenses under § 174(a) or as deferred expenses amortizable ratably over a period of not less than 60 months under § 174(b). Pursuant to § 1.174–1, research and experimental expenditures that are not treated as expenses or deferred expenses under § 174 must be treated as capital expenditures. Further, § 1.174–1 provides that the expenditures to which § 174 applies may relate either to a general research program or to a particular project.

(c) If a taxpayer has not treated research and experimental expenditures as expenses under § 174(a), §§ 174(a)(2)(B) and 1.174–3(b)(2) provide that the taxpayer may, with consent, adopt the expense method at any time.

(d) If a taxpayer has treated research and experimental expenditures as expenses under § 174(a), §§ 174(a)(3) and 1.174–3(b)(3) provide that the taxpayer may, with consent, change to a different method of treating research and experimental expenditures.

(e) If a taxpayer has treated research and experimental expenditures as deferred expenses under § 174(b), §§ 174(b)(2) and 1.174–4(b)(2) provide that the taxpayer may, with consent, change to a different method of treating research or experimental expenditures or to a different period of amortization for deferred expenses.

(2) *Scope.*

(a) *Applicability.* This change applies to any taxpayer that is changing:

(i) from treating research and experimental expenditures for a particular project or projects as expenses under § 174(a) to treating such expenditures as deferred expenses under § 174(b), or vice versa;

(ii) to a different period of amortization for research and experimental expenditures for a particular project or projects that are being treated as deferred expenses under § 174(b); or

(iii) from treating research and experimental expenditures for a particular project or projects as expenses under § 174(a) or deferred expenses under § 174(b) to treating such expenditures as a capital expenditure under § 263(a), or vice versa.

(b) *Scope limitations clarified.* The scope limitation under section 4.02(6) of this revenue procedure is applied on a project by project basis.

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

(i) a portion of the research and experimental expenditures paid or incurred for a particular project during the year of change or in subsequent taxable years (that is, the change must apply to all

of such expenditures; see §§ 1.174–3(a) and 1.174–4(a)(5));

(ii) a change in the treatment of computer software costs under Rev. Proc. 69–21, 1969-–2 C.B. 303; or

(iii) a change in the treatment of Year 2000 costs under Rev. Proc. 97–50, 1997–2 C.B. 525 (but see section 1.02 of this APPENDIX for making this change).

(3) *Manner of making the change.*

(a) This change is made using a cut-off method and applies to all research and experimental expenditures paid or incurred for a particular project or projects during the year of change and in subsequent taxable years. See section 2.06 of this revenue procedure and §§ 174(b)(2), 1.174–3(a), 1.174–3(b)(2), and 1.174–4(a)(5).

(b) The requirement under §§ 1.174–3(b)(2), 1.174–3(b)(3), and 1.174–4(b)(2) to file an application no later than the end of the first taxable year in which the different method or different amortization period is to be used is waived for this change. However, see section 6 of this revenue procedure for filing requirements applicable under this revenue procedure.

(c) The consent granted under this revenue procedure satisfies the consent required under §§ 174(a)(2)(B), 174(a)(3), 174(b)(2), 1.174–3(b)(2), 1.174–3(b)(3), and 1.174–4(b)(2).

(4) *Additional requirement.* A taxpayer must attach to the application a written statement providing:

(a) the information required in § 1.174–3(b)(2) if the taxpayer is changing to treating research and experimental expenditures as expenses under § 174(a);

(b) the information required in § 1.174–3(b)(3) if the taxpayer is changing from treating research and experimental expenditures as expenses under § 174(a); or

(c) the information required in § 1.174–4(b)(2) if the taxpayer is changing from treating research and experimental expenditures as deferred expenses method under § 174(b) or is changing to a different period of amortization for research and experimental expenditures being treated as deferred expenses under § 174(b).

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

.02 *Reserved.*

SECTION 3. CAPITAL EXPENDITURES (§ 263)

.01 *Package design costs.*

(1) *Description of change and scope.*

(a) *Applicability.* This change applies to a taxpayer that wants to change its method of accounting for package design costs that are within the scope of Rev. Proc. 97–35, 1997–2 C.B. 448, to one of the three alternative methods of accounting for package design costs described in section 5 of Rev. Proc. 97–35. The three alternative methods of accounting for package design costs described are: (1) the capitalization method, (2) the design-by-design capitalization and 60-month amortization method, and (3) the pool-of-cost capitalization and 48-month amortization method.

(b) *Inapplicability.* This change does not apply to a taxpayer that wants to change to the capitalization method for costs of developing (or modifying) any package design that has an ascertainable useful life.

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

.02 *Line pack gas; cushion gas.*

(1) Description of change and scope. This change applies to a taxpayer that wants to change its method of accounting for line pack gas or cushion gas to a method consistent with the holding in Rev. Rul. 97–54, 1997–2 C.B. 23. Rev. Rul. 97–54 holds that the cost of line pack gas or cushion gas is a capital expenditure under § 263, the cost of recoverable line pack gas or recoverable cushion gas is not depreciable, and the cost of unrecoverable line pack gas or unrecoverable cushion gas is depreciable under §§ 167 and 168.

(2) *Additional requirements.* A taxpayer that changes its method of accounting for unrecoverable line pack gas or unrecoverable cushion gas under section 3.02 of this APPENDIX must change to a permissible method of accounting for depreciation for the cost of that gas.

SECTION 4. UNIFORM CAPITALIZATION (§ 263A)

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

(1) *Description of change and scope.*

(a) *Applicability.* This change applies to:

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

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

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

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

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

telephone number(s) of the examining agent(s), appeals officer, or counsel for the government, as appropriate.

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

(2) *Definitions.*

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

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

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

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

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

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

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

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

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

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

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

Current Taxable Year	*AVERAGE Annual Gross Receipts for the Three Taxable Years Immediately Preceding the Current Taxable Year*
1991	$ 0
1992	5,000,000
1993	6,000,000
1994	7,000,000
1995	11,000,000
1996	11,000,000
1997	9,000,000
1998	8,000,000
1999	11000,000
2000	12,000,000

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

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

X was required by § 263A to change to the UNICAP method for 1995 because its average annual gross receipts for the three taxable years immediately preceding 1995 were $11,000,000, which exceeded the $10,000,000 ceiling permitted by the small reseller exception. Assume that X was required to capitalize $80,000 of "additional § 263A costs" to the cost of its 1995 beginning inventory because of this change in inventory method. In addition, X was required to include one-fourth of the § 481(a) adjustment when computing taxable income for each of the four taxable years beginning with 1995. Thus, X was required to include a $20,000 positive § 481(a) adjustment in its 1995 taxable income. X elected to use the simplified resale method without a historic absorption ratio election under § 1.263A-3(d)(3) for determining the amount of additional § 263A costs to be capitalized to each LIFO layer. Assume that X was required to add $10,000 of additional § 263A costs to the cost of its 1995 ending inventory because of the $100,000 increment for 1995.

X's 1995 Ending Inventory:

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

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

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

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

X's 1996 Ending Inventory:

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

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

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

Because X satisfies the small reseller exception for 1997, X may change voluntarily from the UNICAP method to a permissible non-UNICAP inventory capitalization method under section 4.01 of this APPENDIX. To reflect the removal of the additional § 263A costs from the cost of its 1997 beginning inventory, X must compute a corresponding § 481(a) adjustment, which is a negative $100,000 ($1,200,000 – $1,300,000). Because X used the UNICAP method for only two years (that is, 1995 and 1996), X must include one-half of the § 481(a) adjustment when computing taxable income for each of the two taxable years beginning with 1997. Thus, X must include a $50,000 negative § 481(a) adjustment in 1997 taxable income. In addition, X must include $20,000 of the unamortized 1995 § 481(a) adjustment in 1997 taxable income.

X's 1997 Ending Inventory:

Beginning Inventory (With UNICAP costs	$1,300,000
1997 Increment	100,000
1997 § 481(a) Adjustment <Negative>	<100,000>
Total 1997 Ending Inventory	$1,300,000

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

Unamortized 1995 § 481(a) Adjustment—12/31/96	$40,000
Amount Included in 1997 Taxable Income	<20,000>
Unamortized 1995 481(a) Adjustment—12/31/97	$20 000

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

1997 § 481(a) Adjustment <Negative>	$<100,000>
Amount Included in 1997 Taxable Income	50,000

Unamortized 1997 § 481(a) Adjustment—12/31/97	$< 50,000>

X also satisfies the small reseller exception for 1998 and, therefore, is not required to return to the UNICAP method for 1998. X, however, must include $20,000 of the unamortized 1995 positive § 481(a) adjustment and $50,000 of the unamortized 1997 negative § 481(a) adjustment in 1998 taxable income.

X's 1998 Ending Inventory:

Beginning Inventory (Without UNICAP costs)	$1,300,000
1998 Increment	100,000
Total 1998 Ending Inventory	$1,400,000

X's Unamortized 1995 § 48(a) Adjustment:

Unamortized 1995 § 481(a) Adjustment—12/31/97	$ 20,000
Amount Included in 1998 Taxable Income	<20,000>
Unamortized 1995 § 481(a) Adjustment—12/31/98	$ 0

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

Unamortized 1997 § 481(a) Adjustment—12/31/97	$<50,000>
Amount Included in 1998 Taxable Income	50,000
Unamortized 1997 § 481(a) Adjustment—12/31/98	$ 0

In 1999, X fails to satisfy the small reseller exception and, therefore, must return to the UNICAP method as provided under section 4.01 of this APPENDIX. X changes to the simplified resale method without a historic absorption ratio election under § 1.263A-3(d)(3). Assume that X must capitalize $120,000 of additional § 263A costs to the cost of its 1999 beginning inventory because of this change in inventory method. In addition, X must determine the appropriate adjustment period for the corresponding positive § 481(a) adjustment. Because X used its former inventory method for two taxable years before 1999 (that is, 1997 and 1998), X must include one-half of the § 481(a) adjustment when computing taxable income for each of the two taxable years beginning with 1999. Thus, X must include a $60,000 positive § 481(a) adjustment in its 1999 taxable income. Assume that X must add $10,000 of additional § 263A costs to the cost of its 1999 ending inventory because of the $100,000 increment for 1999.

X's 1999 Ending Inventory:

Beginning Inventory (Without UNICAP costs)	$1,400,000
1999 Increment	100,000
Additional § 263A costs in Beginning Inventory	120,000
Additional § 263A costs in 1999 Increment	10,000
Total 1999 Ending Inventory	$1,630,000

X's Unamortized 1999 § 481

1999 § 481(a) Adjustment	$120,000
Amount Included in 1999 Taxable Income	< 60,000>
Unamortized 1999 § 481(a) Adjustment—12/31/99	$ 60,000

Because X fails to satisfy the small reseller exception for 2000, X must continue using the UNICAP method for its inventory costs. Furthermore, X is required to include $60,000 of the unamortized 1999 positive § 481(a) adjustment in 2000 taxable income. Assume that X is required to add $10,000 of additional § 263A costs to the cost of its 2000 ending inventory because of the $100,000 increment for 2000.

X's 2000 Ending Inventory:

Beginning Inventory (With UNICAP costs)	$1,630,000
2000 Increment	100,000
Additional § 263A Costs in 2000 Increment	10,000
Total 2000 ending inventory	$1,740,000

X's Unamortized 1999 § 481(a) Adjustment:

Unamortized 1999 § 481(a) Adjustment—12/31/99	$60,000
Amount Included in 2000 Taxable Income	<60,000>
Unamortized 1999 § 481(a) Adjustment—12/31/00	$ 0

.02 *Reserved.*

SECTION 5. METHODS OF ACCOUNTING (§ 446)

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

(1) *Description of change and scope.*

(a) *Applicability.* This change applies to:

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

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

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

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

(ii) a farmer;

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

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

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

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

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

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

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

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

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

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

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

(3) *Change to a special method of accounting.* If a taxpayer that wants to change to an accrual method in conjunction with a change to a special method of accounting is not permitted to make the change under this revenue procedure, the taxpayer may request to make both changes only by filing one application under the provisions of Rev. Proc. 97–27, 1997–1 C.B. 680. Only one user fee will be required for these changes.

.02 *Multi-year service warranty contracts.*

(1) *Description of change and scope.*

(a) *Applicability.* This change applies to an eligible accrual method manufacturer, wholesaler, or retailer of motor vehicles or other durable consumer goods that wants to change to the service warranty income method described in section 5 of Rev. Proc. 97–38, 1997–2 C.B. 479. Under the service warranty income method, a qualifying taxpayer may, in certain specified and limited circumstances, include a portion of an advance payment related to the sale of a multi-year service warranty contract in gross income generally over the life of the service warranty obligation.

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

(2) *Manner of making the change.*

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

(b) In accordance with § 1.446–1(e)(3)(ii), the requirement of § 1.446–1(e)(3)(i) to file an application on Form 3115 is waived and a statement in lieu of the Form 3115 is authorized for this change. The statement must be identified at the top as follows: **"CHANGE TO THE SERVICE WARRANTY INCOME METHOD UNDER SECTION 5.02 OF THE APPENDIX OF REV. PROC. 98–60."** The statement must set forth the information required under section 6.03 of Rev. Proc. 97–38, except that the statement under section 6.03(2) (that the taxpayer agrees to all of the terms and conditions of the revenue procedure) also should refer to Rev. Proc. 98–60.

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

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

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

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

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

.04 *Interest accruals on short-term consumer loans — Rule of 78s method.*

(1) *Description of change and scope.*

(a) *Applicability.* This change applies to a taxpayer that wants to change its method of accounting from the Rule of 78s method to the constant yield method for stated interest (including stated interest that is original issue discount) on short-term consumer loans described in Rev. Proc. 83–40, 1983–1 C.B. 774, which was obsoleted by Rev. Proc. 97–37, 1997–2 C.B. 455.

(b) *Scope limitations inapplicable.* A taxpayer that wants to make this change for its first or second taxable year beginning on or after January 1, 1998, is not subject to the scope limitations in section 4.02 of this revenue procedure. However, if the taxpayer is under examination, before an appeals office, or before a federal court, the taxpayer must provide a copy of the application to the examining agent(s), appeals officer, or counsel for the government, as appropriate, at the same time that it files the copy of the application with the national office. The application must contain the name(s) and telephone number(s) of the examining agent(s), appeals officer, or counsel for the government, as appropriate.

(2) *Background.*

(a) A short-term consumer loan is described in Rev. Proc. 83-40, provided:

(i) the loan is a self-amortizing loan that requires level payments, at regular intervals at least annually, over a period not in excess of five years (with no balloon payment at the end of the loan term); and

(ii) the loan agreement between the borrower and the lender provides that interest is earned, or upon the prepayment of the loan interest is treated as earned, in accordance with the Rule of 78s method.

(b) *In general,* the Rule of 78s

method allocates interest over the term of a loan based, in part, on the sum of the periods' digits for the term of the loan. *See* Rev. Rul. 83–84, 1983–1 C.B. 97, for a description of the Rule of 78s method.

(c) In general, the constant yield method allocates interest and original issue discount over the term of a loan based on a constant yield. See § 1.1272–1(c) for a description of the constant yield method. The Rule of 78s method generally front-loads interest as compared to the constant yield method.

(d) Rev. Proc. 83–40 was obsoleted because, under §§ 1.446–2 and 1.1272–1 (which were effective for debt instruments issued on or after April 4, 1994), taxpayers generally must account for stated interest and original issue discount on a debt instrument (loan) by using a constant yield method. As a result, the Rule of 78s method is no longer an acceptable method of accounting for federal income tax purposes.

(e) Notwithstanding §§ 1.446–2 and 1.1272–1, as a matter of administrative convenience, the Service will allow a taxpayer to use the Rule of 78s method for stated interest on short-term consumer loans described in Rev. Proc. 83-40 if the loans were issued prior to the first day of the taxpayer's first taxable year that begins on or after January 1, 1999.

(3) *Manner of making the change.*

(a) This change is made using a cut-off method and applies only to loans issued on or after the first day of the year of change. *See* section 2.06 of this revenue procedure.

(b) The taxpayer must maintain books and records sufficient to satisfy the district director that loans issued before the year of change and loans issued on or after the first day of the year of change have been adequately accounted for separately.

SECTION 6. OBLIGATIONS ISSUED AT DISCOUNT (§ 454)

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

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

(2) *Manner of making the change.*

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

(b) In accordance with § 1.446–1(e)(3)(ii), the requirement of § 1.446–1(e)(3)(i) to file an application on Form 3115 is waived and a statement in lieu of the Form 3115 is authorized for this change. The statement must be identified at the top as follows: **"CHANGE IN METHOD OF ACCOUNTING UNDER SECTION 6.01 OF THE APPENDIX OF REV. PROC. 98–60."** The statement must set forth:

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

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

(iii) an agreement to report all interest on the bonds acquired before the year of change when the interest is realized upon disposition, redemption, or final maturity, whichever is earliest, with the exception of any interest income previously reported in prior taxable years.

.02 *Reserved.*

SECTION 7. PREPAID SUBSCRIPTION INCOME (§ 455)

.01 *Prepaid subscription income.*

(1) *Description of change and scope.* This change applies to an accrual method taxpayer that wants to change its method of accounting for prepaid subscription income to the method described in § 455 and the regulations thereunder, including an eligible taxpayer that wants to make the "within 12 months" election under § 1.455–2.

(2) *Manner of making the change.*

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

(b) In accordance with § 1.446–1(e)(3)(ii), the requirement of § 1.446–1(e)(3)(i) to file an application on Form 3115 is waived and a statement in lieu of the Form 3115 is authorized for this change. The statement must be identified at the top as follows: **"CHANGE IN METHOD OF ACCOUNTING FOR PREPAID SUBSCRIPTION INCOME UNDER SECTION 7.01 OF THE APPENDIX OF REV. PROC. 98–60."** The statement must set forth the information required under § 1.455–(b).

(c) The consent granted under this revenue procedure satisfies the consent required under §§ 455(c)(3) and 1.455–6(b).

.02 *Reserved.*

SECTION 8. TAXABLE YEAR OF DEDUCTION (§ 461)

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

(1) *Description of change and scope.*

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

(i) *Bonuses.* If the obligation to pay a bonus becomes fixed and certain by the end of the taxable year (*see* Rev. Rul. 61–127, 1961–2 C.B. 36), and the bonus is otherwise deductible, but the bonus is paid after the 15th day of the third calendar month after the end of that taxable year, to treat the bonus as deductible in the taxable year of the employer in which or with which ends the taxable year of the employee in which the bonus is includible in the gross income of the employee; or

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

(1987), 1987-2 C.B. 134.

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

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

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

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

(2) *Scope.*

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

(i) treat a liability for real property taxes (for which the all events test of § 461(h)(4) is otherwise met) as incurred in the taxable year in which the taxes are paid, under §§ 461 and 1.461–4(g)(6);

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

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

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

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

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

(1) *Description of change and scope.*

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

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

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

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

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

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

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

(1) *Description of change and scope.*

(a) *Applicability.* This change applies to an accrual method employer that wants to change its method of accounting for FICA and FUTA taxes to a method consistent with the holding in Rev. Rul. 96–51, 1996–2 C.B. 36. Rev. Rul. 96–51 holds that, under the all events test of § 461, an accrual method employer may deduct in Year 1 its otherwise deductible FICA and FUTA taxes imposed with respect to year-end wages properly accrued in Year 1, but paid in Year 2, if the requirements of the recurring item exception are met.

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

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

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

.05 *Cooperative advertising.*

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

wants to change its method of accounting for cooperative advertising costs to a method consistent with the holding in Rev. Rul. 98–39, 1998–33 I.R.B. 4. Rev. Rul. 98-–39 generally provides that, under the all events test of § 461, an accrual method manufacturer's liability to pay a retailer for cooperative advertising services is incurred in the year in which the services are performed, provided the manufacturer is able to reasonably estimate this liability, and even though the retailer does not submit the required claim form until the following year.

(2) *Scope limitations inapplicable.* A taxpayer that wants to make this change for its first or second taxable year ending on or after August 17, 1998, is not subject to the scope limitations in section 4.02 of this revenue procedure. However, if the taxpayer is under examination, before an appeals office, or before a federal court, the taxpayer must provide a copy of the application to the examining agent(s), appeals officer, or counsel for the government, as appropriate, at the same time that it files the copy of the application with the national office. The application must contain the name(s) and telephone number(s) of the examining agent(s), appeals officer, or counsel for the government, as appropriate.

SECTION 9. INVENTORIES (§ 471)

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

.02 *Estimating inventory "shrinkage".*

(1) *Description of change and scope.* This change applies to a taxpayer that wants to change to a method of accounting for estimating inventory shrinkage in computing ending inventory, using:

(a) the "retail safe harbor method" described in section 4 of Rev. Proc. 98–29, 1998–15 I.R.B. 22; or

(b) a method other than the retail safe harbor method, provided (i) the taxpayer's present method of accounting does not estimate inventory shrinkage, and (ii) the taxpayer's new method of accounting (that estimates inventory shrinkage) clearly reflects income under § 446(b).

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

(3) *Additional requirements.* If the taxpayer wants to change to a method of accounting for inventory shrinkage other than the retail safe harbor method, the taxpayer must attach to the application a statement setting forth a detailed description of all aspects of the new method of estimating inventory shrinkage (including, for LIFO taxpayers, the method of determining inventory shrinkage for, or allocating inventory shrinkage to, each LIFO pool).

(4) *Audit protection.* A taxpayer, whose present method of accounting estimates inventory shrinkage, does not receive audit protection under section 7 of this revenue procedure in connection with a change to the retail safe harbor method if, on the date the taxpayer files a copy of the Form 3115 with the national office, the taxpayer's present method of estimating inventory shrinkage is an issue under consideration within the meaning of section 3.09 of this revenue procedure.

(5) *Future change.* A taxpayer that changes to the retail safe harbor method described in this revenue procedure will not be precluded, solely by reason of such change, from changing to another safe harbor method for estimating inventory shrinkage in computing ending inventory in the first year that such other safe harbor method is available.

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

.01 *Change from the LIFO inventory method.*

(1) *Description of change and scope.*

(a) *In general.* This change applies to any taxpayer that wants to:

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

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

(b) *Method to be used.*

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

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

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

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

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

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

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

(B) the valuation method is cost; cost or market, whichever is lower; market (but only if the taxpayer is a dealer in securities, as defined in § 1.471–5); the "farm price method" or the "unit-live-

stock-price method" (but only if the taxpayer is a farmer permitted to use such methods); or the retail method, reduced to either approximate cost or approximate cost or market, whichever is lower (but only if the taxpayer is a retail merchant).

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

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

(2) *Limitation on LIFO election.* The taxpayer may not re-elect the LIFO inventory method for a period of at least five taxable years beginning with the year of change, unless based on a showing of unusual and compelling circumstances, consent is specifically granted by the Commissioner to change the method of accounting at an earlier time. A taxpayer that wants to re-elect the LIFO inventory method within a period of five taxable years (beginning with the year of change) must file a Form 3115 in accordance with Rev. Proc. 97–27, 1997–1 C.B. 680. A taxpayer that wants to re-elect the LIFO inventory method after a period of five taxable years (beginning with the year of change) is not required to file a Form 3115 in accordance with Rev. Proc. 97–27, but must file a Form 970, Application to Use LIFO Inventory Method, in accordance with § 1.472–3.

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

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

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

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

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

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

(c) "The new method conforms to the requirements of section 10.01(1)(b)(i) [insert either (A), (B), (C), or (D)] of the APPENDIX of Rev. Proc. 98-60 because [explain in detail how the new method conforms to the specific subdivision]."

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

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

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

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

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

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

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

(1) *Description of change and scope.*

(a) *Applicability.* This change applies to a taxpayer engaged in the trade or business of retail sales of new automobiles or new light-duty trucks ("automobile dealer") that wants to change to the "Alternative LIFO Method" described in section 4 of Rev. Proc. 97–36, 1997–2 C.B. 450, for its LIFO inventories of new automobiles and new light-duty trucks. Light-duty trucks are trucks with a gross vehicle weight of 14,000 pounds or less, which also are referred to as class 1, 2, or 3 trucks.

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

(2) *Manner of making the change.*

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

(b) *IPIC method changes.* An automobile dealer that uses the IPIC method also must change from the IPIC method under section 10.03 of this APPENDIX to another acceptable method for its goods other than new automobiles and new light-duty trucks. For parts and accessories, the automobile dealer must change

to the dollar-value, index method, with all parts and accessories within each separate trade or business in a separate LIFO pool. For used vehicles, the automobile dealer must change to the dollar-value, link-chain method, with all used automobiles within each separate trade or business in one LIFO pool and all used trucks within each separate trade or business in another separate LIFO pool.

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

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

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

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

(1) *Description of change and scope.*

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

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

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

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

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

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

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

(3) *Bargain purchase.* If the taxpayer has previously improperly accounted for a bulk bargain purchase, the taxpayer must, as part of this change, first change its method of accounting to comply with *Hamilton Industries, Inc. v. Commissioner,* 97 T.C. 120 (1991), and compute a § 481(a) adjustment for that part of the change. See Announcement 91–173, 1991–47 I.R.B. 29. Upon examination, if a taxpayer has properly changed under section 10.04 of this APPENDIX except for complying with section 10.04(3) of this APPENDIX, an examining agent may not deny the taxpayer the change. However, the taxpayer does not receive audit protection under section 7 of this revenue procedure with respect to the improper method of accounting for the bargain purchase. Accordingly, the examining agent may make any necessary adjustments in any open year to effect compliance with *Hamilton Industries, Inc.*

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

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

(a) by reference to the actual cost of the goods most recently purchased or produced;

(b) by reference to the actual cost of the goods purchased or produced during the taxable year in the order of acquisition; or

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

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

SECTION 10A. MARK-TO-MARKET ACCOUNTING METHOD FOR DEALERS IN SECURITIES (§ 475)

.01 *Discontinuing the mark-to-market method of accounting for nonfinancial customer paper.*

(1) *Description of change and scope.*

(a) *Applicability.* This change applies to:

(i) a taxpayer that must discontinue the use of the mark-to-market method of accounting for nonfinancial customer paper to comply with § 475(c)(4), enacted by § 7003 of the IRS Restructuring and Reform Act of 1998, Pub. L. No. 105–206, 112 Stat. 833 (July 22, 1998), provided the change is made for the taxpayer's first taxable year ending after July 22, 1998. The taxpayer must change to a method other than the lower of cost or market method; and

(ii) a taxpayer that was a dealer in securities solely because of its dealings in nonfinancial customer paper, that, in conjunction with the change under section 10A.01(1)(a)(i) of this APPENDIX, wants to discontinue the use of the mark-to-market method of accounting for all securities (including nonfinancial customer paper).

(b) *Scope limitations inapplicable.* A taxpayer that wants to make this change is not subject to the scope limitations in

section 4.02 of this revenue procedure. However, if the taxpayer is under examination, before an appeals office, or before a federal court, the taxpayer must provide a copy of the application to the examining agent(s), appeals officer, or counsel for the government, as appropriate, at the same time that it files the copy of the application with the national office. The application must contain the name(s) and telephone number(s) of the examining agent(s), appeals officer, or counsel for the government, as appropriate.

(2) *Additional Requirements.*

(a) On a statement attached to the application, the taxpayer must describe all items that were marked to market and that will no longer be marked to market.

(b) When complying with section 6.02(3) of this revenue procedure, the taxpayer should indicate whether the taxpayer is changing under section 10A.01(1)(a)(i) or sections 10A.01(1)a)(i) and (ii) of this APPENDIX.

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

.02 Reserved.

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

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

(1) *Description of change and scope.*

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

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

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

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

(ii) any bank within the scope of Rev. Proc. 97–18, 1997–1 C.B. 642, which applies to banks making this change in method of accounting in 1997 to become eligible to elect S corporation status for 1997. A bank is not outside the scope of Rev. Proc. 97–18 solely because it is a qualified subchapter S subsidiary. In that event, the S corporation (the parent) should follow the application procedures required by Rev. Proc. 97–18 on behalf of the bank.

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

(3) *Change from § 585 required when electing S corporation status.* A bank electing S corporation status (or a bank for which a QSSS election is filed) cannot use the § 585 reserve method. The filing by a bank of a Form 2553 (Election by a Small Business Corporation) or the filing by a bank's parent of a QSSS election with respect to the bank will constitute an agreement by the bank to change its method of accounting for bad debts from the § 585 reserve method to the § 166 specific charge-off method effective as of the taxable year for which the S corporation election or QSSS election is effective (year of change) in accordance with all of the applicable provisions of this revenue procedure. The § 481(a) adjustment is recognized built-in gain under § 1374. *See* § 1.1374–4(d).

.02 *Reserved.*

SECTION 12. ORIGINAL ISSUE DISCOUNT (§§ 1272; 1273)

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

(1) *Description of change and scope.*

(a) *Applicability.* This change applies to a taxpayer that wants to change to the principal-reduction method of accounting described in section 5 of Rev. Proc. 97–39, 1997–2 C.B. 485. The principal-reduction method of accounting is an aggregate method of accounting for de minimis OID (discount) on certain loans originated by the taxpayer.

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

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

(2) *Manner of making the change.*

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

(b) The taxpayer must maintain

books and records sufficient to satisfy the district director that old and new loans have been adequately segregated.

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

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

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

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

.02 *Pool of debt instruments.*

(1) *Description of change and scope.*

(a) *Applicability.* This change applies to a taxpayer that must change its method of accounting for a pool of debt instruments to comply with § 1272(a)(6) (as required by § 1004 of the Taxpayer Relief Act of 1997, Pub. L. No. 105–34, 111 Stat. 788, 911), provided the change is for the taxpayer's first taxable year beginning after August 5, 1997.

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

(c) *Description.*

(i) Under § 1272, the holder of a debt instrument with original issue discount (OID) must include in income the sum of the daily portions of the OID for each day during the taxable year on which the holder held the instrument. Section 1272(a)(6) provides special rules to determine the daily portions of OID for certain debt instruments subject to prepayments. Under these rules, the daily portions of OID are determined, in part, by taking into account an assumption regarding the prepayment of principal on the debt instruments.

(ii) Section 1004 of the Taxpayer Relief Act of 1997, which is effective for taxable years beginning after August 5, 1997, extended the rules in § 1272(a)(6) to any pool of debt instruments the yield on which may be affected by reason of prepayments. In particular, § 1272(a)(6) now applies to a pool of credit card receivables subject to a grace period provision (under which, for example, a credit card issuer does not charge interest for a billing cycle if the credit card obligor pays off its account balance by a specified date, even though the balance is not due on that date). *See* H.R. Conf. Rep. No. 220, 105th Cong., 1st Sess. 522 (1997). (A credit card receivable subject to a grace period provision has OID because none of the stated interest on the receivable is qualified stated interest under § 1.1273–1(c)).

(iii) The holder of a pool of credit card receivables subject to a grace period provision must accrue OID on the pool based on a reasonable assumption regarding the timing of the payments by the obligors of the receivables in the pool. Under §1272(a)(6), it is not reasonable for a holder to assume that all of the obligors will pay their balances by the specified grace period date and, based on this assumption, defer the inclusion of OID until the end of the grace period. If the payments in the pool occur soon after year end and before the holder files its tax return for the taxable year that includes such year end, the holder may accrue OID based on its actual experience rather than based upon a reasonable assumption. If the holder does not accrue OID based on its actual experience, the holder must make an adjustment to its income for the following taxable year to account for any difference between its accrual based on a reasonable assumption and its actual experience.

(2) *Additional requirements.*

(a) On a statement attached to the application, the taxpayer must provide a detailed description of the pool(s) of debt instruments and the proposed method (including the prepayment assumption used for each pool).

(b) A taxpayer that, on or before March 1, 1999, files its original federal income tax return for its first taxable year beginning after August 5, 1997, may comply with the filing requirement in section 6.02(2)(a) of this revenue procedure or with the following filing requirement. The taxpayer must complete and file an application in duplicate. The original application must be attached to the taxpayer's timely filed amended federal income tax return for the taxpayer's first taxable year beginning after August 5, 1997. This amended return must be filed no later than April 30, 1999. A copy of the application must be filed with the national office (see section 6.02(6) of this revenue procedure for the address) no later than when the taxpayer's amended return is filed.

SECTION 13. SHORT-TERM OBLIGATIONS (§ 1281)

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

(1) *Description of change and scope.*

(a) This change applies to a taxpayer that wants to change its method of accounting to comply with § 1281 for interest income on short-term obligations.

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

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

(d) Under §§ 1281(a) and 1283(c), a holder of a short-term obligation subject to § 1281 must include in gross income an amount equal to the sum of the daily portions of the acquisition discount or OID, whichever is applicable, on the obligation for each day during the taxable year that the obligation is held by the holder. *See* § 1283(b), as modified by § 1283(c), to determine the daily portions of acquisi-

tion discount or OID. In addition, § 1281(a) requires the holder to include in gross income any stated interest that is payable on the short-term obligation (other than stated interest taken into account to determine the amount of the acquisition discount or OID) as it accrues.

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

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

(1) *Description of change and scope.*

(a) This change applies to a cash method bank in the Eighth Circuit that wants to change its method of accounting from accruing stated interest on short-term loans made in the ordinary course of business to using the cash method for that interest.

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

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

(3) *No ruling protection.* If the Service is later successful in further litigation on this issue in other circuits, or there is a change in law, then cash method banks in the Eighth Circuit may be required to use an accrual method of accounting for any taxable year not barred by the statute of limitations.

Part IV. Items of General Interest

Foundations Status of Certain Organizations

Announcement 98–112

The following organizations have failed to establish or have been unable to maintain their status as public charities or as operating foundations. Accordingly, grantors and contributors may not, after this date, rely on previous rulings or designations in the Cumulative List of Organizations (Publication 78), or on the presumption arising from the filing of notices under section 508(b) of the Code. This listing does *not* indicate that the organizations have lost their status as organizations described in section 501(c)(3), eligible to receive deductible contributions.

Former Public Charities. The following organizations (which have been treated as organizations that are not private foundations described in section 509(a) of the Code) are now classified as private foundations:

H C I T, Uniontown, PA
H E L P Center Inc., Monroe, NC
H O S E A Inc., West Allis, WI
H T D Vet Inc., Cedar Hill, MO
H-Town Pony Express, Huntsville, AL
Habitat for Humanities of Palestine Chapter Inc., Palestine, TX
Habitat for Humanity of Greater Garland Inc., Garland, TX
Haitian Agricultural Renaissance Fund, Abington, PA
Haitian American Alliance for Progress Inc., Laurelton, NY
Hajjco Inc., East Orange, NJ
Halcyone Production, Chicago, IL
Halifax County-South Boston Sports Hall of Fame, South Boston, VA
Hallelujah Voices Inc., Brockton, MA
Hamilton County Economic Development Foundation, Harrison, TN
Hamlins Horizon Ministries Inc., Phoenix, AZ
Hampton Roads Aids Walk Foundation, Norfolk, VA
Hancock County Corporation for Independent Living, Findlay, OH
Hand Foundation of San Antonio, San Antonio, TX
Handicapped Employee and Learning Program of New Mexico, Taos, NM
Hands Across Greene County Incorporated, Jasonville, IN
Hands and Hearts for Needy Children Inc., Garner, NC
Hands Inc., Great Falls, MT
Hands of Christ a Duluth Cooperative Ministry Inc., Duluth, GA
Hands on Child Development Inc., Minneapolis, MN
Hands on Memphis Inc., Memphis, TN
Hanover Youth Athletic Association, Hanover, MA
Happe Programs for Personal, Rochester, NY
Harbour House Ministries Incorporated, Clanton, AL
Harlem Community Inc., New York, NY
Harlem Volunteer Ambulance Corp., New York, NY
Harmon House, Detroit, MI
Harmony House Inc., Madison, WI
Harmony Ministries Inc., Tulsa, OK
Harpazo Inc., Chicago, IL
Harpeth Foundation Inc., Brentwood, TN
Harpo Inc., Hunger and Relief Program of Oklahoma Inc., Crowder, OK
Hartline Hospice Memorial Fund Inc., Springfield, MO
Hathaway Ministries Inc., Wooster, OH
Hatznei Leches Charitable Foundation Charity Through Anonymi, Brooklyn, NY
Haven House Inc., Colorado Springs, CO
Hazelnut Project, Seattle, WA
HBHCI Home Corporation, New Port Richey, FL
Healing Musical Ministries Inc., Fairfax, VA
Healing Resources, Cleveland Heights, OH
Health Awareness Inc., Cockeysville, MD
Health Through Communications Foundation, La Mesa, CA
Health Van, Fort Collins, CO
Healthcare Education Inc., Melbourne, FL
Heart to Heart Ministries Inc., Carmel, IN
Heartfire, Sioux Falls, SD
Heartflight, Albuquerque, NM
Heartland Youth Ministries, Burlington, IA
Hearts of Peace Inc., Ivorytown, CT
Heavenly High Ministry Fellowship Inc., Rockville, MD
Hegman Family Foundation, Edina, MN
Helen and Stuart Over MD Center for Holistic Living, Santa Barbara, CA
Help & Learn Inc., Jacksonville, TX
Help Feed the Kids Inc., Houston, TX
Help Our Playground Inc., Manasquan, NJ
Help the Children Inc., Chicago, IL
Helping Electra Local People, Electra, TX
Helping Hand Projects for the Blind, Joplin, MO
Helping Hands-Hospice of Ionia County Inc., Ionia, MI
Helping Hands Ministries, Charles Town, WV
Helping Hands of Cleveland Inc., Cleveland, OH
Helping Other People Evolve Successfully Inc., Chicago, IL
Helping Others Pursue Excellence, Houston, TX
Helping Russian Hospitals Heal, Annville, PA
Helpline Inc., Jonesboro, AR
Hendersonville Youth Football & Cheerleader Organization Inc., Hendersonville, NC
Henry County Child Abuse Prevention Council Inc., New Castle, IN
Heron Courtney Waddy Memorial Scholarship Fund, Missouri City, TX
Heureka Center for Disease Prevention and Health Promotion, Willingboro, NJ
Hibernian Foundation Inc., Milwaukee, WI
High Point Alcohol & Drug Action Coalition Inc., High Point, NC
Higher Authority Productions Inc., Bal Harbour, FL
Highland Area Recreation Project Robert Siegel Treasurer, St. Paul, MN
Highland Park Community Outreach, Highland Park, MI
Highlands Ranch Touchdown Club, Highlands Ranch, CO
Highways & Hedges Outreach, San Antonio, TX
Hillcat Athletic Booster Club Inc., Hillsboro, NH
Hill-Grainger Neighborhood Revitalization Corporation, Kinston, NC
Hillsborough Moving Company, Tampa, FL
Hillsdale Playground Association Inc., Hillsdale, NJ

Hillside Early Childhood Learning Center Inc., Jackson, MS
Hilton Head Community Foundation, Hilton Head Island, SC
Hindi Punjabi Samaj of North America Inc., Wilson, NC
His Majestys Messengers Inc., Laramie, WY
Hispanic Community of Great Neck Inc., Great Neck, NY
Hispanic Leaders Group of Greater St. Louis, St. Louis, MO
Hispanic Research League Inc., New York, NY
Historic Concord Preservation TR, Concord, NC
Historic Roger Mills Preservation and Development Foundation Inc., Cheyenne, OK
Historic Sites & Shipwrecks Restoration & Preservation SCY Inc., Fort Lauderdale, FL
Historical Chatham Roseland Englewood Westside CDC, Chicago, IL
Historical Society of the Pound, Pound, VA
HMI Inc., New Orleans, LA
HNC Corporation, Fredericksburg, VA
Hockessin Area Heritage Association, Hockessin, DE
Holcombe Superstars of Tomorrow, Houston, TX
Holiness Unto God Ministries-H U G, Hammond, IN
Holly Annette Davila, Thornton, CO
Holly Coast Retirement Community Inc., Holly Ridge, NC
Hollywood for Children Inc., New York, NY
Hollywood Golf Institute Inc., Detroit, MI
Holmes County Quality of Life Association, Lexington, MS
Home Resource Corporation, Los Osos, CA
Homefields, Lancaster, PA
Holy Bible Mission Church, Baltimore, MD
Holy Cross Community Development Corporation, New Orleans, LA
Holy Cross Lutheran Church Foundation Inc., Sarasota, FL
Holy Ghost Ministries, Markham, IL
Home Builders Foundation of Western Mass Inc., Springfield, MA
Homeless Cat Project International, Yarmouth, ME
Homeless Critters Humane Society in Pine County Inc., Pine City, MN
Homeless Education & Resource Organization, Columbia, SC
Homeless Empowerment Relationship Organization Inc., Flint, MI
Homeless Enrichment Liaison Program, Philadelphia, PA
Homeless Helpers Inc., Scottsdale, AZ
Homes for Independent Disabled HID Inc., Phoenix, AZ
Homesmart, Auburn, ME
Hoot Owl Servants Corporation, Spokane, WA
Hope for the World Foundation Inc., Orlando, FL
Homosexual Education for Latter Day Saints Parents, Pleasanton, CA
Hoosier Gospel Jubilee Inc., Indianapolis, IN
Hoosier Hurricanes, Hobart, IN
Hoot N Holler Cloggers Inc., Huntsville, AL
Hope Orlando Inc., Orlando, FL
Hope Outreach Inc., Dallas, TX
Hope Inc., Ormond Beach, FL
Hope Ministries International, Castle Rock, CO
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Housing Solutions Inc., New Orleans, LA
Housing Starts Inc., Atlanta, GA
Houston Area Outreach Coalition Inc., Houston, TX
Houston Chinese Culture & Art Foundation Incorporated, Houston, TX
Houston County Visitors Center-Museum Inc., Crockett, TX
Houston Educational Excellence Foundation, Houston, TX
Houston Shoes for Needy Children Inc., Houston, TX
Howland Team Sports H T S, Warren, OH
Hudson Community Food Pantry Inc., Boston, MA
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Hugo Community Foundation Inc., Hugo, OK
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Humble Area Veterans Memorial Association Inc., Humble, TX
Hunger is Curable Inc., Rockville, MD
Huron Housing Corporation, Sandusky, OH

If an organization listed above submits information that warrants the renewal of its classification as a public charity or as a private operating foundation, the Internal Revenue Service will issue a ruling or determination letter with the revised classification as to foundation status. Grantors and contributors may thereafter rely upon such ruling or determination letter as provided in section 1.509(a)–7 of the Income Tax Regulations. It is not the practice of the Service to announce such revised classification of foundation status in the Internal Revenue Bulletin.

Changes to Codes for Roth IRAs on Form 1099–R (Announcement 98–106 Corrected)

Announcement 98–113

Purpose

The purpose of this announcement is to advise payers making distributions from Roth IRAs of changes to the distributions codes on Form 1099–R, Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.

Background

The Internal Revenue Service Restructuring and Reform Act of 1998 (Public Law 105–206) amended Internal Revenue Code section 408A, dealing with Roth IRAs. Because of these amendments, the Service has concluded that code K, "Distribution from a 1998 Roth conversion IRA in the first 5 years," on the 1998 Form 1099–R may no longer serve its intended purpose. In addition, a new code for recharacterizations is needed.

1998 Form 1099–R

Code K, to be used in box 7 on the 1998 Form 1099–R, is now optional. Payers may choose to use Code J in box 7 for all distributions from a Roth IRA or Roth conversion IRA. They will meet the requirements of Q/A-B–2 of Notice 98–49, 1998–38 I.R.B. 5, if they use Code J instead of Code K.

1999 Form 1099–R

Code K will be eliminated on the 1999 Form 1099–R. Code J will be changed to "Distribution from a Roth IRA." Use Code J when reporting any distribution from a Roth IRA or Roth conversion IRA. New Code R, "Recharacterized IRA contribution," will be added to identify a recharacterization of an IRA contribution.

Definition of Terms

Revenue rulings and revenue procedures (hereinafter referred to as "rulings") that have an effect on previous rulings use the following defined terms to describe the effect:

Amplified describes a situation where no change is being made in a prior published position, but the prior position is being extended to apply to a variation of the fact situation set forth therein. Thus, if an earlier ruling held that a principle applied to A, and the new ruling holds that the same principle also applies to B, the earlier ruling is amplified. (Compare with *modified*, below).

Clarified is used in those instances where the language in a prior ruling is being made clear because the language has caused, or may cause, some confusion. It is not used where a position in a prior ruling is being changed.

Distinguished describes a situation where a ruling mentions a previously published ruling and points out an essential difference between them.

Modified is used where the substance of a previously published position is being changed. Thus, if a prior ruling held that a principle applied to A but not to B, and the new ruling holds that it applies to both A and B, the prior ruling is modified because it corrects a published position. (Compare with *amplified* and *clarified*, above).

Obsoleted describes a previously published ruling that is not considered determinative with respect to future transactions. This term is most commonly used in a ruling that lists previously published rulings that are obsoleted because of changes in law or regulations. A ruling may also be obsoleted because the substance has been included in regulations subsequently adopted.

Revoked describes situations where the position in the previously published ruling is not correct and the correct position is being stated in the new ruling.

Superseded describes a situation where the new ruling does nothing more than restate the substance and situation of a previously published ruling (or rulings). Thus, the term is used to republish under the 1986 Code and regulations the same position published under the 1939 Code and regulations. The term is also used when it is desired to republish in a single ruling a series of situations, names, etc., that were previously published over a period of time in separate rulings. If the new ruling does more than restate the substance of a prior ruling, a combination of terms is used. For example, *modified* and *superseded* describes a situation where the substance of a previously published ruling is being changed in part and is continued without change in part and it is desired to restate the valid portion of the previously published ruling in a new ruling that is self contained. In this case the previously published ruling is first modified and then, as modified, is superseded.

Supplemented is used in situations in which a list, such as a list of the names of countries, is published in a ruling and that list is expanded by adding further names in subsequent rulings. After the original ruling has been supplemented several times, a new ruling may be published that includes the list in the original ruling and the additions, and supersedes all prior rulings in the series.

Suspended is used in rare situations to show that the previous published rulings will not be applied pending some future action such as the issuance of new or amended regulations, the outcome of cases in litigation, or the outcome of a Service study.

Abbreviations

The following abbreviations in current use and formerly used will appear in material published in the Bulletin.

A—Individual.
Acq.—Acquiescence.
B—Individual.
BE—Beneficiary.
BK—Bank.
B.T.A.—Board of Tax Appeals.
C.—Individual.
C.B.—Cumulative Bulletin.
CFR—Code of Federal Regulations.
CI—City.
COOP—Cooperative.
Ct.D.—Court Decision.
CY—County.
D—Decedent.
DC—Dummy Corporation.
DE—Donee.
Del. Order—Delegation Order.
DISC—Domestic International Sales Corporation.
DR—Donor.
E—Estate.
EE—Employee.
E.O.—Executive Order.
ER—Employer.
ERISA—Employee Retirement Income Security Act.
EX—Executor.
F—Fiduciary.
FC—Foreign Country.
FICA—Federal Insurance Contribution Act.
FISC—Foreign International Sales Company.
FPH—Foreign Personal Holding Company.
F.R.—Federal Register.
FUTA—Federal Unemployment Tax Act.
FX—Foreign Corporation.
G.C.M.—Chief Counsel's Memorandum.
GE—Grantee.
GP—General Partner.
GR—Grantor.
IC—Insurance Company.
I.R.B.—Internal Revenue Bulletin.
LE—Lessee.
LP—Limited Partner.
LR—Lessor.
M—Minor.
Nonacq.—Nonacquiescence.
O—Organization.
P—Parent Corporation.
PHC—Personal Holding Company.
PO—Possession of the U.S.
PR—Partner.
PRS—Partnership.
PTE—Prohibited Transaction Exemption.
Pub. L.—Public Law.
REIT—Real Estate Investment Trust.
Rev. Proc.—Revenue Procedure.
Rev. Rul.—Revenue Ruling.
S—Subsidiary.
S.P.R.—Statements of Procedral Rules.
Stat.—Statutes at Large.
T—Target Corporation.
T.C.—Tax Court.
T.D.—Treasury Decision.
TFE—Transferee.
TFR—Transferor.
T.I.R.—Technical Information Release.
TP—Taxpayer.
TR—Trust.
TT—Trustee.
U.S.C.—United States Code.
X—Corporation.
Y—Corporation.
Z—Corporation.

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[1] A cumulative list of all revenue rulings, revenue procedures, Treasury decisions, etc., published in Internal Revenue Bulletins 1998–1 through 1998–28 will be found in Internal Revenue Bulletin 1998–29, dated July 20, 1998.

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