

Part III

Administrative, Procedural, and Miscellaneous

26 CFR 601.204: Changes in accounting periods and in methods of accounting.
(Also Part 1, §§ 162, 263, 446, 461, 481; 1.167(a)-3(b), 1.263(a)-4, 1.263(a)-5, 1.446-1, 1.461-4, 1.461-5, 1.481-1)

Rev. Proc. 2005-9

SECTION 1. PURPOSE

This revenue procedure provides the exclusive administrative procedures under which a taxpayer described in section 4 of this revenue procedure may obtain automatic consent for the taxpayer's second taxable year ending on or after December 31, 2003, to change to a method of accounting provided in §§ 1.263(a)-4, 1.263(a)-5, and 1.167(a)-3(b) of the Income Tax Regulations (the "final regulations").

SECTION 2. BACKGROUND

.01 On January 5, 2004, the Internal Revenue Service and Treasury Department published final regulations in the Federal Register (TD 9107; 69 FR 436). Section 1.263(a)-4 prescribes the extent to which taxpayers must capitalize amounts paid or incurred to acquire or create (or to facilitate the acquisition or creation of) intangibles. Section 1.263(a)-5 prescribes the extent to which taxpayers must capitalize amounts paid or incurred to facilitate an acquisition of a trade or business, a change in the capital structure of a business entity, and certain other transactions. Section 1.167(a)-3(b) provides a safe harbor useful life for certain intangible assets. The final regulations

under §§ 1.263(a)-4 and 1.263(a)-5 are effective for amounts paid or incurred on or after December 31, 2003. The final regulations under § 1.167(a)-3(b) are effective for intangible assets created on or after December 31, 2003.

.02 Sections 1.263(a)-4(p) and 1.263(a)-5(n) provide that a taxpayer seeking to change to a method of accounting provided in the final regulations must secure the consent of the Commissioner in accordance with the requirements of § 1.446-1(e). In addition, §§ 1.263(a)-4(p) and 1.263(a)-5(n) provide that, for the taxpayer's first taxable year ending on or after December 31, 2003, the taxpayer is granted the consent of the Commissioner to change to a method of accounting provided in the final regulations, provided the taxpayer follows the administrative procedures issued under § 1.446-1(e)(3)(ii) for obtaining the Commissioner's automatic consent to a change in accounting method (for further guidance, for example, see Rev. Proc. 2002-9, 2002-1 C.B. 327, as modified and clarified by Announcement 2002-17, 2002-1 C.B. 561, modified and amplified by Rev. Proc. 2002-19, 2002-1 C.B. 696, and amplified, clarified, and modified by Rev. Proc. 2002-54, 2002-2 C.B. 432). The final regulations further provide that any applicable § 481(a) adjustment for a change to a method of accounting provided in the final regulations for a taxpayer's first taxable year ending on or after December 31, 2003, is determined by taking into account only amounts paid or incurred in taxable years ending on or after January 24, 2002. The preamble to the final regulations states that the Service may issue additional guidance for utilizing the automatic consent procedures to change to a method of accounting provided in the regulations.

.03 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.

.04 Rev. Proc. 2002-9 provides procedures by which a taxpayer may obtain automatic consent to change to a method of accounting described in the Appendix of Rev. Proc. 2002-9.

.05 Rev. Rul. 90-38, 1990-1 C.B. 57, provides that, if a taxpayer uses an erroneous method of accounting for two or more consecutive taxable years, the taxpayer has adopted a method of accounting. The ruling further provides that a taxpayer may not, without the Commissioner's consent, retroactively change from an erroneous to a permissible method of accounting by filing an amended return.

.06 Rev. Proc. 2004-23, 2004-16 I.R.B. 785, provides the exclusive administrative procedures under which a taxpayer may obtain automatic consent for the taxpayer's first taxable year ending on or after December 31, 2003, to change to a method of accounting provided in the final regulations and, if desired, to change to a method of utilizing the 3½ month rule authorized by § 1.461-4(d)(6)(ii) or the recurring item exception authorized by § 1.461-5 in conjunction with a change to a method of accounting provided in the final regulations. Under Rev. Proc. 2004-23, a term and condition of the Commissioner's consent with respect to a change to a method of accounting provided in the final regulations is that any applicable § 481(a) adjustment take into account only amounts paid or incurred in taxable years ending on or after January 24, 2002. In addition, Rev. Proc. 2004-23 states that for taxable years subsequent to the first taxable year ending on or after December 31, 2003, a similar

term and condition will apply. (For further background, see Section 2 of Rev. Proc. 2004-23.)

.07 This revenue procedure applies only for a taxpayer's second taxable year ending on or after December 31, 2003. As in Rev. Proc. 2004-23, this revenue procedure grants taxpayers the Commissioner's consent to change to a method of utilizing the 3½ month rule or the recurring item exception only for the item for which the taxpayer is simultaneously changing to a method of accounting provided in the final regulations. In addition, a term and condition of obtaining the Commissioner's consent, whether or not automatic, is that any applicable § 481(a) adjustment take into account only amounts paid or incurred in taxable years ending on or after January 24, 2002. The Service intends to issue future guidance for changes in methods of accounting made for subsequent taxable years, including automatic consent procedures for some or all methods of accounting provided in the final regulations. Such guidance will include as a term and condition of obtaining the Commissioner's consent, whether or not automatic, that any applicable § 481(a) adjustment take into account only amounts paid or incurred in taxable years ending on or after January 24, 2002.

.08 This revenue procedure constitutes the exclusive guidance for utilizing the automatic consent procedures to change to a method of accounting provided in the final regulations for a taxpayer's second taxable year ending on or after December 31, 2003. For any change in method of accounting to which this revenue procedure applies, a taxpayer may not file an application for a change in method of accounting under Rev. Proc. 97-27, 1997-21 I.R.B. 10 (as modified and amplified by Rev. Proc. 2002-19, 2002-13 I.R.B. 696, as amplified and clarified by Rev. Proc. 2002-54, 2002-35 I.R.B. 432).

See section 4.02(1) of Rev. Proc. 97-27.

SECTION 3. HOW THIS REVENUE PROCEDURE DIFFERS FROM REV. PROC.

2004-23

.01 Rev. Proc. 2004-23 applies to a taxpayer's first taxable year ending on or after December 31, 2003. This revenue procedure applies to a taxpayer's second taxable year ending on or after December 31, 2003.

.02 Rev. Proc. 2004-23 waives the scope limitations in section 4.02 of Rev. Proc. 2002-9. This revenue procedure does not waive those limitations.

.03 Rev. Proc. 2004-23 does not require taxpayers to complete many of the lines in Part II of Form 3115. Because this revenue procedure does not waive the scope limitations of Rev. Proc. 2002-9, this revenue procedure requires taxpayers to complete more of the lines in Part II of Form 3115. See section 5.02(2)(d) of this revenue procedure.

SECTION 4. SCOPE

.01 This revenue procedure applies to a taxpayer that seeks, for the taxpayer's second taxable year ending on or after December 31, 2003, to change to a method of accounting provided in the final regulations.

.02 This revenue procedure also applies to a taxpayer that, for the taxpayer's second taxable year ending on or after December 31, 2003, in addition to seeking a change to a method of accounting provided in the final regulations, also seeks to change its method of accounting to utilize the 3½ month rule authorized by § 1.461-4(d)(6)(ii) or to utilize the recurring item exception authorized by § 1.461-5.

SECTION 5. APPLICATION

.01 *In general.* A taxpayer within the scope of this revenue procedure is, in accordance with section 6.01 of Rev. Proc. 2002-9, granted the consent of the Commissioner to change to a method of accounting provided in the final regulations (and, if desired, to also utilize the 3½ month rule authorized by § 1.461-4(d)(6)(ii) or the recurring item exception authorized by § 1.461-5) provided that the taxpayer follows the automatic change in method of accounting provisions in Rev. Proc. 2002-9, with the following modifications:

(1) The taxpayer must prepare and file Form 3115, Application for Change in Accounting Method, in accordance with section 5.02 of this revenue procedure;

(2) The copy of Form 3115 must be sent to the following special address (note the special post office box number): Commissioner of Internal Revenue, Attention: CC:ITA (Automatic Rulings Branch, Rev. Proc. 2005-9 Filing) P.O. Box 7616, Benjamin Franklin Station, Washington, D.C. 20044 (or in the case of a private delivery service or hand delivery to the courier's desk: Commissioner of Internal Revenue, Attention: CC:ITA (Automatic Rulings Branch, Rev. Proc. 2005-9 Filing), 1111 Constitution Avenue, N.W., Washington, D.C. 20224);

(3) The taxpayer must compute any applicable § 481(a) adjustment and take such adjustment into account in accordance with section 6 of this revenue procedure; and

(4) A taxpayer described in section 5.03(2) of this revenue procedure must file one or more amended federal income tax returns (amended returns) in accordance with section 5.03(3), (4), or (5), as applicable, of this revenue procedure.

.02 *Form 3115.* In preparing the Form 3115 referred to in section 5.01 of this

revenue procedure, a taxpayer must comply with the following procedures:

- (1) The taxpayer may use one Form 3115 for all changes in method of accounting made pursuant to the final regulations;
- (2) The taxpayer is required to complete only the following information on Form 3115:
 - (a) The identification section of Page 1 (above Part I);
 - (b) The signature section at the bottom of Page 1;
 - (c) Part I, Line 1(a). The designated automatic accounting method change number for changes in method of accounting made pursuant to this revenue procedure is No. "78";
 - (d) Part II, all lines except lines 11, 13, 14, 15, and 17 (for purposes of completing line 12, see section 6.02(2) of this revenue procedure if the taxpayer is making more than one change in method of accounting);
 - (e) Part IV, in accordance with section 6 of this revenue procedure;and
 - (f) Schedule E, if applicable;
- (3) In addition to the other information required on line 12 of Form 3115, the taxpayer must include the citation to the paragraph of the final regulations that provides for the proposed method of accounting for each item (e.g., § 1.263(a)-4(d)(6) or § 1.263(a)-4(f)), and, if applicable, whether the taxpayer is also proposing to change to a method that uses the 3½ month rule authorized by § 1.461-4(d)(6)(ii) or the recurring item exception authorized by § 1.461-5 with respect to the item;
- (4) In addition to the other information required on Schedule E of Form

3115 (if applicable), the taxpayer must include a statement as to whether the useful life is the safe harbor useful life prescribed by § 1.167(a)-3(b)(1) or § 1.167(a)-3(b)(1)(iv) and, if the useful life is the safe harbor useful life prescribed by § 1.167(a)-3(b)(1), a statement explaining why the intangible asset does not have a useful life the length of which can be estimated with reasonable accuracy; and

(5) A taxpayer that must file one or more amended returns as provided in section 5.03 of this revenue procedure to be eligible to use the automatic consent procedures of this revenue procedure must attach to the Form 3115 a written statement signed under penalties of perjury confirming that the taxpayer has filed the amended returns pursuant to section 5.03 of this revenue procedure.

.03 Unauthorized change in a preceding year.

(1) A taxpayer may change a method of accounting only with the consent of the Commissioner. § 1.446-1(e)(2). A taxpayer that changes a method of accounting without the consent of the Commissioner has made an unauthorized change in method of accounting. If a taxpayer makes an unauthorized change in method of accounting, the Service may adjust the taxpayer's taxable income during the examination of the taxpayer's income tax return for the taxable year the unauthorized change was made and for all affected subsequent years. In the notice of proposed rulemaking that preceded the publication of the final regulations (REG-125638-01; 67 FR 77701), the Service and Treasury Department advised taxpayers not to seek to change a method of accounting in reliance on rules contained in the notice of proposed rulemaking until the rules were published as final regulations. The Service and Treasury Department are aware that some taxpayers have made an unauthorized change in method of

accounting for an item the treatment of which is provided for in the final regulations. The Service and Treasury Department have determined that it is not appropriate for taxpayers that have made an unauthorized change in method of accounting for an item the treatment of which is provided for in the final regulations to obtain automatic consent under this revenue procedure without correcting such unauthorized change. Therefore, a taxpayer that made an unauthorized change in method of accounting for an item the treatment of which is provided for in the final regulations is eligible to use the automatic consent procedures provided in this revenue procedure only if the taxpayer amends prior federal income tax returns to correct the unauthorized change in method of accounting. However, as a matter of administrative grace, the Service and Treasury Department have limited the application of this section 5.03 to certain taxpayers described in section 5.03(2) of this revenue procedure.

(2) This section 5.03 applies to a taxpayer that –

(a) in a taxable year for which the due date of the federal income tax return (including extensions, regardless of whether such extension is automatic and whether or not actually requested) is after January 24, 2002 --

(i) made any unauthorized change in method of accounting for an item the treatment of which is provided for in the final regulations; or

(ii) impermissibly changed the treatment of an item that is provided for in the final regulations in the taxpayer's first taxable year ending on or after December 31, 2003, but has only used such treatment on one federal income tax return; or

(b) made an unauthorized change in method of accounting to a

method of accounting that is provided in the final regulations in a taxable year for which the due date of the federal income tax return (including extensions, regardless of whether such extension is automatic and whether or not actually requested) is on or before January 24, 2002, and for which the statute of limitations has not yet expired, if the taxpayer wishes to use the automatic consent procedures to obtain the Commissioner's consent to change to the same method of accounting to which the taxpayer previously made the unauthorized change.

(3) A taxpayer described in section 5.03(2)(a)(i) of this revenue procedure is eligible to use the automatic consent procedures to obtain the Commissioner's consent to change to a method of accounting provided in the final regulations only if the taxpayer changes back to the prior method of accounting (*i.e.*, the method of accounting used for an item prior to making the unauthorized change for the item) for each item referred to in section 5.03(2)(a) of this revenue procedure by amending its federal income tax returns for all of the preceding taxable years in which the unauthorized method (or methods) was used.

(4) A taxpayer described in section 5.03(2)(a)(ii) of this revenue procedure is eligible to use the automatic consent procedures to obtain the Commissioner's consent to change to a method of accounting provided in the final regulations only if the taxpayer amends its federal income tax return for the preceding taxable year in which the unauthorized treatment was used to change the treatment of each item referred to in section 5.03(2)(a) of this revenue procedure to a treatment consistent with the taxpayer's historic method of accounting (*i.e.*, the method of accounting used for an

item prior to changing the treatment of the item).

(5) A taxpayer described in section 5.03(2)(b) of this revenue procedure is eligible to use the automatic consent procedures to obtain the Commissioner's consent to change to the same method of accounting provided in the final regulations to which the taxpayer previously made the unauthorized change only if the taxpayer changes back to its prior method of accounting for the item (*i.e.*, the method of accounting used for the item prior to making the unauthorized change for the item) by amending its federal income tax returns for all of the preceding taxable years in which the unauthorized method was used.

(6) A taxpayer filing one or more amended returns pursuant to section 5.03(3), (4), or (5) of this revenue procedure must file the amended returns on or before the date the taxpayer files a Form 3115 under this revenue procedure (including the copy of Form 3115 filed with the national office under section 5.01(2) of this revenue procedure) for the taxpayer's second taxable year ending on or after December 31, 2003. For this purpose, a taxpayer under examination will be considered to have filed an amended return by providing the amended return to the examining agent.

(7) In accordance with § 1.446-1(e)(3)(ii) and Rev. Rul. 90-38, consent is hereby granted for a taxpayer described in section 4.01 of this revenue procedure that also is described in section 5.03(2)(a)(i) or (b) of this revenue procedure to file the amended returns referred to in section 5.03(3) or (5) of this revenue procedure to retroactively change its method of accounting. This consent is granted for the taxable year for which the taxpayer made the unauthorized change and for any subsequent taxable year affected by the unauthorized change.

.04 *Prior change.* For purposes of this revenue procedure, a change in method of accounting made pursuant to Rev. Proc. 2004-23 (including a change required to be made on an amended return as provided by section 4.03 of Rev. Proc. 2004-23) for an item is not treated as a prior change of the same method of accounting within the meaning of section 4.02(6) of Rev. Proc. 2002-9 with respect to a different item covered by this revenue procedure. Thus, for example, a taxpayer that obtained automatic consent under Rev. Proc. 2004-23 to change to a method of applying the 12-month rule to prepaid property insurance is not prohibited by section 4.02(6) of Rev. Proc. 2002-9 from obtaining consent under this revenue procedure to change to a method of applying the 12-month rule to the taxpayer's prepaid licenses and permits.

SECTION 6. COMPUTATION OF SECTION 481(a) ADJUSTMENT

.01 *In general.* A taxpayer changing a method of accounting under this revenue procedure is required to take into account any applicable § 481(a) adjustment as provided in §§ 1.263(a)-4(p)(3) and 1.263(a)-5(n)(3). The § 481(a) adjustment is computed as of the first day of the taxpayer's second taxable year ending on or after December 31, 2003, and, as provided in the final regulations, takes into account only amounts paid or incurred in taxable years ending on or after January 24, 2002. Thus, the § 481(a) adjustment is computed by taking into account only amounts paid or incurred in the period beginning with the first day of the taxable year that includes January 24, 2002, and ending with the last day of the first taxable year ending on or after December 31, 2003. The amount of the § 481(a) adjustment must include (i) as a reduction of taxable income, any amounts paid or incurred in the period beginning with the first day of the taxable year that includes January 24, 2002, and ending with the last

day of the first taxable year ending on or after December 31, 2003, that were capitalized under the taxpayer's present method of accounting and are currently deductible under the taxpayer's proposed method of accounting, reduced by the amount of such capitalized costs recovered through amortization or depreciation under the taxpayer's present method of accounting, (ii) as an increase to taxable income, any amounts paid or incurred in the period beginning with the first day of the taxable year that includes January 24, 2002, and ending with the last day of the first taxable year ending on or after December 31, 2003, that were currently deducted under the taxpayer's present method of accounting and are capitalized under the taxpayer's proposed method of accounting, reduced by the amount of capitalized costs that would have been recovered through amortization or depreciation if the taxpayer's proposed method of accounting had been applied in taxable years ending on or after January 24, 2002, and (iii) as an increase or a reduction to taxable income, as appropriate, any other adjustments required as a result of the change in method of accounting. If under its present method of accounting a taxpayer capitalized costs incurred prior to the first taxable year that includes January 24, 2002, the taxpayer must continue to treat amortization or depreciation deductions attributable to those costs in accordance with the taxpayer's present method of accounting. Thus, for example, a taxpayer that files its federal income tax return on a calendar year basis continues to amortize or depreciate in 2004 an intangible created in 2001, even though the taxpayer has changed to a method of accounting provided in the final regulations under which the entire cost of the intangible would be currently deductible if incurred in 2004.

.02 Reporting the section 481(a) adjustment on Form 3115.

(1) *Netting*. For purposes of determining the adjustment period under section 2.05(2) of Rev. Proc. 2002-9, the § 481(a) adjustment is determined separately for each change in method of accounting being made under this revenue procedure. Thus, a positive adjustment attributable to a change in one method may not be netted against a negative adjustment attributable to a change in another method. However, in determining the adjustment attributable to a change in method, a taxpayer must net positive § 481(a) adjustments and negative § 481(a) adjustments resulting from that change in method (e.g., if a taxpayer changes to a method of applying the 12-month rule to prepaid amounts, the taxpayer must net the resulting negative § 481(a) adjustment with the positive § 481(a) adjustment that results from including those amounts in inventory pursuant to the taxpayer's existing § 263A method of accounting for inventory).

(2) *Itemized listing on Form 3115*. The taxpayer must include on Form 3115, Part IV, line 25, the total § 481(a) adjustment for all changes in methods of accounting being made. If the taxpayer is making more than one change in method of accounting under the final regulations, the taxpayer must include on an attachment to Form 3115 –

(a) the information required by Part IV, line 25 for each change in method of accounting (including the amount of the § 481(a) adjustment for each change in method of accounting);

(b) the information required by Part II, line 12 of Form 3115 that is associated with each change; and

(c) the citation to the paragraph of the final regulations that provides for

each proposed method of accounting (e.g., § 1.263(a)-4(d)(6) or § 1.263(a)-4(f)).

.03 *Example:* Y, a calendar year taxpayer that uses an accrual method of accounting, is a service provider not required to maintain inventories. Y wishes to change to a method of accounting provided in the final regulations for taxable year 2004, which is Y's second taxable year ending on or after December 31, 2003. Y incurred and capitalized \$100x in taxable year 2001, \$200x in taxable year 2002, and \$250x in taxable year 2003. In addition, Y incurred \$300x in taxable year 2004. The \$100x, \$200x, and \$250x capitalized and depreciated by Y in 2001, 2002, and 2003 all relate to the same method of accounting and would be currently deductible under the final regulations if the amounts had been incurred on or after December 31, 2003. Y claimed a depreciation deduction of \$10x in each of the taxable years 2001, 2002, and 2003 with respect to the \$100x incurred and capitalized in 2001, a depreciation deduction of \$20x in each of the taxable years 2002 and 2003 with respect to the \$200x incurred and capitalized in 2002, and a depreciation deduction of \$25x in taxable year 2003 with respect to the \$250x incurred and capitalized in 2003. For taxable year 2004, Y may apply for an automatic change in method of accounting with respect to the method under which the amounts had been capitalized. Y's section 481(a) adjustment is a decrease in income of \$385x (\$160x relating to amounts capitalized in 2002 (\$200x - \$40 (\$20 for 2002 and \$20 for 2003)) + \$225x relating to amounts capitalized in 2003 (\$250x - \$25x)). Y must continue to use its present method of accounting for the amount capitalized in 2001. Y uses its new method of accounting for the amount incurred in 2004.

SECTION 7. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 2002-9 is modified and amplified to include these automatic changes in method of accounting in section 3 of the APPENDIX.

SECTION 8. EFFECTIVE DATE

This revenue procedure is effective for a taxpayer's second taxable year ending on or after December 31, 2003.

SECTION 9. DRAFTING INFORMATION

The principal author of this revenue procedure is Grace Matuszeski of the Associate Chief Counsel (Income Tax and Accounting). For further information regarding this revenue procedure call Ms. Matuszeski at (202) 622-7900 (not a toll free call).