

## Part III

### Administrative, Procedural, and Miscellaneous

26 CFR 601.204: Changes in accounting periods and methods of accounting.  
(Also Part I, §§ 442; 1.442-1)

Rev. Proc. 2003-79

#### SECTION 1. PURPOSE

Rev. Proc. 2002-38, 2002-1 C.B. 1037, and Rev. Proc. 2002-39, 2002-1 C.B. 1046, provide procedures for a partnership or S corporation to change its annual accounting period if its current taxable year no longer qualifies as a natural business year (or, for certain S corporations, an ownership taxable year). This revenue procedure provides procedures under which a partner or S corporation shareholder (within the scope of this revenue procedure) of such a partnership or S corporation may elect to take into account ratably over four taxable years the partner's or S corporation shareholder's share of income from the partnership or S corporation that is attributable to the short taxable year ending on or after May 10, 2002, but before June 1, 2004.

#### SECTION 2. BACKGROUND

.01 Section 442 of the Internal Revenue Code and § 1.442-1(a) of the Income Tax Regulations generally provide that a taxpayer that wants to change its annual accounting period and use a new taxable year must obtain the approval of the Commissioner.

.02 Section 1.442-1(b)(2) provides, in relevant part, that a change in annual accounting period will be approved only where the taxpayer agrees to the Commissioner's prescribed terms, conditions, and adjustments for effecting the change.

.03 Section 1.442-1(b)(3) provides that such terms, conditions, and adjustments may include adjustments necessary to neutralize the tax effects of a substantial distortion of income that would otherwise result from the requested annual accounting period.

.04 Rev. Proc. 2002-38 provides the exclusive procedures for certain partnerships and S corporations to obtain automatic approval to adopt, change, or retain their annual accounting periods under § 442 and § 1.442-1(b). Among the provisions of Rev. Proc. 2002-38:

(1) Section 4 provides that a partnership or S corporation may secure the Commissioner's approval to adopt or change to its "required taxable year," a "natural business year," or an "ownership taxable year;"

(2) Section 5.04 defines a "permitted taxable year" to include a required taxable year, natural business year, or ownership taxable year;

(3) Section 5.05 provides that a partnership or S corporation establishes a natural business year by satisfying a "25-percent gross receipts test;"

(4) Section 5.06 provides generally that an S corporation shareholder that is a tax-exempt entity under § 501(a) and that is not subject to tax on any income attributable to the S corporation is disregarded for purposes of determining an ownership taxable year of the S corporation unless the S corporation is wholly-owned by such tax-exempt entity; and

(5) Sections 6.05 and 6.06 provide that if a taxpayer changes to or retains a natural business year or an ownership taxable year and that year no longer qualifies as a permitted taxable year, the taxpayer is using an impermissible annual accounting period and should change to a permitted taxable year under Rev. Proc. 2002-38 or Rev. Proc. 2002-39, whichever applies.

.05 Rev. Proc. 2002-39 provides the exclusive procedures for taxpayers, including partnerships and S corporations, that do not qualify under one of the automatic approval procedures, to obtain prior approval of the Commissioner to adopt, change, or retain their annual accounting periods under § 442 and § 1.442-1(b). Among the provisions of Rev. Proc. 2002-39:

(1) Section 5.01 provides that a request to adopt, change, or retain an annual accounting period ordinarily will be approved if the taxpayer establishes a business purpose;

(2) Section 5.02 provides that a taxpayer requesting to adopt, change, or retain an annual accounting period that is the taxpayer's natural business year has established a business purpose to the satisfaction of the Commissioner;

(3) Section 5.03 provides that a natural business year of a taxpayer may be determined under the "annual business cycle test," the "seasonal business test," or the "25% gross receipts test;" and

(4) Section 5.04 provides that if a partnership or S corporation changed to or retained under Rev. Proc. 2002-39 a taxable year that was its natural business year, and that taxable year no longer qualifies as a permitted taxable year, the partnership or S corporation is using an impermissible annual accounting period and should change to a permitted taxable year under Rev. Proc. 2002-38 or Rev. Proc. 2002-39, whichever applies.

.06 In the case of a partnership or S corporation that changes its taxable year to a permitted taxable year, a partner or S corporation shareholder may be required to include in gross income in a single taxable year income items and expense items from more than one taxable year of the partnership or S corporation. The Internal Revenue Service and Treasury Department have determined that it is appropriate to allow partners and S corporation shareholders within the scope of this revenue procedure to elect to spread ratably over a four-year period their share of income from the partnership's or S corporation's short taxable year.

### SECTION 3. DEFINITIONS

For purposes of this revenue procedure:

.01 *Share of income.* The term "share of income" means a partner's or S corporation shareholder's share of "income items" that exceeds its share of "expense items" from the partnership or S corporation that are attributable to the short taxable year;

.02 *Income Items and Expense Items.* The terms "income items" and "expense items" have the same meaning as in § 1.702-3T(b).; and

.03 *Short Taxable Year.* The term "short taxable year" means the short taxable year of the partnership or S corporation that is required to effect the change in annual accounting period. An initial short year following an election under section 1362(a) will not be considered a "short taxable year" for purposes of this revenue procedure.

### SECTION 4. SCOPE

This revenue procedure applies to a partner or S corporation shareholder, if:

.01 The partnership or S corporation has changed, or will change, its taxable year solely because either:

(1) its current taxable year no longer qualifies as a natural business year under Rev. Proc. 2002-38 or Rev. Proc. 2002-39, whichever applies; or

(2) in the case of an S corporation, its current taxable year no longer qualifies as an ownership taxable year because a tax-exempt owner is disregarded under section 5.06 of Rev. Proc. 2002-38;

.02 The partnership's or S corporation's short taxable year ends on or after May 10, 2002, but before June 1, 2004 (or, in the case of a taxpayer that uses a 52-53-week taxable year, with reference to the last day of any calendar month after April 30, 2002, and before June 1, 2004);

.03 As a consequence of the partnership or S corporation changing its taxable year to a permitted taxable year, income items and expense items from more than one taxable year of the partnership or S corporation would, but for the provisions of this revenue procedure, be includible in the income of the partner or S corporation shareholder in a single taxable year; and

.04 The partner's or S corporation shareholder's share of income items exceeds its share of expense items attributable to the short taxable year of the partnership or S corporation.

## SECTION 5. FOUR-YEAR SPREAD PERIOD

.01 A partner or S corporation shareholder within the scope of this revenue procedure may elect to take into account its share of income from the short taxable year of the partnership or S corporation ratably over a four-year period.

.02 A partner or S corporation shareholder within the scope of this revenue procedure that elects a ratable four-year spread period under this revenue procedure must apply the provisions of § 1.702-3T (b), (d), (e), (f) and (g) with the following modifications for purposes of this section:

(1) the term "partner" in §1.702-3T means any partner or S corporation shareholder within the scope of this revenue procedure;

(2) the term "partnership" includes S corporations;

(3) the term "distributive share" includes a shareholder's pro rata share of S corporation items; and

(4) references to "section 806 of the 1986 Act" should be replaced with "Rev. Proc. 2002-38 or Rev. Proc. 2002-39, whichever applies."

## SECTION 6. PROCEDURES FOR ELECTING FOUR-YEAR SPREAD PERIOD

A partner or S corporation shareholder within the scope of this revenue procedure that wants to elect to spread income ratably over a four-year period under this revenue procedure must make the election by:

(1) recording the appropriate ratable income amount (*i.e.*, one quarter of its share of income) on either:

(a) a timely filed original federal income tax return for the taxable year of the partner or S corporation shareholder with or within which the partnership's or S corporation's short taxable year ends; or

(b) in the case of a partner or S corporation shareholder within the scope of this revenue procedure that wants to make the four-year spread period election, but prior to November 24, 2003, has timely filed a federal income tax return for the taxable year with or within which the partnership's or S corporation's short taxable year ends, on an appropriate amended federal income tax return that is filed on or before April 12, 2004; and

(2) attaching to the original or amended federal income tax return for the taxable year with or within which the partnership's or S corporation's short taxable year ends, and to the federal income tax returns for every other taxable year of the spread period, a completed Form 8082, *Notice of Inconsistent Treatment or Administrative Adjustment Request*, containing an explanation in Part III similar to the following: "Election under Rev. Proc. 2003-79 to apply a ratable 4-year spread of the share of income attributable to a change in annual accounting period."

#### SECTION 7. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 2002-38 and Rev. Proc. 2002-39 are modified.

#### DRAFTING INFORMATION

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