Internal Revenue Service
DEPARTMENT OF THE TREASURY

LB&I Process Unit

Unit Name	Identifying and Handling Claims for Changes in Accounting Methods	
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Book	Change in Methods
Chapter	Involuntary Change in Method (Service-Initiated)

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Table of Contents

(View this PowerPoint in "Presentation View" to click on the links below)

Table of Contents (cont'd)

(View this PowerPoint in "Presentation View" to click on the links below)

Process Overview

Identifying and Handling Claims for Changes in Accounting Methods

This practice unit discusses how to determine whether a claim is a request for a change in accounting method and how you should handle the claim. Prior to using this practice unit, you should have knowledge of basic accounting method concepts and the voluntary change in accounting method procedures.

During an examination, taxpayers may submit formal or informal claims for examination adjustments that reduce taxable income and result in a refund of taxes. Taxpayers and examiners refer to these adjustments as affirmative adjustments, self-audit adjustments, or similar terms. These claims for examination adjustments are often requests for changes in accounting methods.

A taxpayer chooses a method of accounting in the first year the taxpayer reflects the item on a tax return. Once a taxpayer adopts a method of accounting for an item, it cannot change the method, even from an impermissible one, without the Commissioner's consent. See IRC 446(e). The general mechanism for a voluntary change in accounting method is for a taxpayer to file a Form 3115, *Application for Change in Accounting Method*. The taxpayer makes the accounting method change prospectively (that is, on a yet to be filed return). The voluntary method change procedures do not allow a taxpayer to file an amended return or informal claim to change an accounting method on a previously filed tax return. See Rev. Rul. 90-38; Rev. Proc. 2015-13, Section 2.03. The Internal Revenue Service (IRS or Service) refers to these types of claims as a taxpayer-initiated request for a retroactive change in accounting method.

In general, you should deny the claim and refer the taxpayer to the voluntary method change procedures. You should not allow a taxpayer-initiated request for a retroactive change in accounting method because a taxpayer under examination should not obtain more advantageous terms and conditions than a taxpayer who is not under examination. That is, a taxpayer under examination should not be able to change an accounting method in an earlier year than a taxpayer who is not under examination and must make the change prospectively. You should not expend limited IRS resources on a taxpayer-initiated request for a retroactive change in accounting method when procedures exist for a taxpayer to change its accounting method voluntarily. See Rev. Proc. 2002-18.

Detailed Explanation of the Process

Identifying and Handling Claims for Changes in Accounting Methods
Analysis
This process addresses how you identify a claim requesting a change in accounting method and how you should handle this type of claim. Neither the Code nor regulations define the term “method of accounting.” In general, a method of accounting is a set of rules under which a taxpayer determines when to include an item in income, or when to deduct an item in determining taxable income (for example, depreciation and deferred revenue). A taxpayer chooses a method of accounting for an item in the first year it reflects the item on a tax return. Once a taxpayer adopts a method for an item, it generally must abide with that choice unless it obtains consent from the Commissioner to change to a different method. *Pacific National Co. v. Welch*, 304 U.S. 191 (1938); *Capital One Financial Corp. v. C.I.R.*, 659 F.3d 316 (4th Cir. 2011). The intent of the consent requirement is to help lessen the Commissioner’s burden of administering the tax laws. The consent requirement serves to promote accounting uniformity, normalize the collection of revenue, prevent distortions and inconsistencies in reporting, and ensure that the government does not tax income twice or not at all. Requiring a taxpayer to obtain the Commissioner’s consent before changing its method of accounting also gives the Commissioner authority to approve or disapprove a prospective change. There are procedures all taxpayers must follow to request consent to change an accounting method. In general, a taxpayer files an application for a change in accounting method (Form 3115) to request a change in accounting method using either the automatic or the non-automatic method change procedures. See Rev. Proc. 2015-13. The taxpayer files the application for a prospective method change, meaning it will make the change on a yet to be filed tax return. The taxpayer files the application during the year of change for a non-automatic change, or with its next filed return for an automatic change. For example, a taxpayer who requests a non-automatic method change for 2022 files a Form 3115 during the 2022 tax year. The method change is prospective because the taxpayer has not yet filed its 2022 tax return.

Detailed Explanation of the Process (cont'd)

Identifying and Handling Claims for Changes in Accounting Methods
Analysis
It is important to identify whether a taxpayer has filed a claim requesting a change in accounting method because the procedures specifically state that a taxpayer may not amend a tax return to change a method of accounting or request a retroactive change in accounting method. You should generally deny a claim requesting a change in accounting method and refer the taxpayer to the voluntary change in accounting method procedures. The voluntary change in accounting method procedures provide the mechanism for a taxpayer who wants to change a method of accounting to secure the consent of the Commissioner as required by IRC 446. The voluntary method change rules also promote compliance by offering more favorable terms and conditions for taxpayer-initiated method changes than Service-initiated method changes. A taxpayer under examination should not obtain more advantageous terms and conditions from a retroactive change in accounting method than a taxpayer who is not under examination. Examples: ▪ A taxpayer places an asset in service in 2018 and depreciates it using a 15-year recovery period. In the process of filing its 2020 tax return, the taxpayer determines the recovery period for this asset is 5 years. To change its method of accounting from a 15-year recovery period to a 5-year recovery period, the taxpayer must follow the voluntary method change procedures and file a Form 3115 with a subsequently filed tax return (for example, its 2020 return). The method change to the shorter recovery period is effective with the filing of the 2020 return, and results in a taxpayer-favorable adjustment decreasing taxable income in 2020. ▪ Assume the same facts as the prior example, except that the taxpayer's 2018 tax return is under examination. During the examination, the taxpayer submits an informal claim for 2018 to change its accounting method for the asset from the 15-year recovery period to a 5-year recovery period. If you allow the informal claim in 2018, the taxpayer under examination benefits from the method change (the shorter recovery period) two years earlier than a taxpayer who is not under examination. You should deny the claim and advise the taxpayer to follow the voluntary method change procedures to make the change prospectively.

Detailed Explanation of the Process (cont'd)

Identifying and Handling Claims for Changes in Accounting Methods
Analysis
The IRS's refusal to make taxpayer-requested retroactive method changes is consistent with equitable tax administration because the taxpayer chooses the original method of accounting on its filed tax return and may change from one method of accounting to a different one on a prospective basis by following the voluntary method change procedures. Routine consideration of taxpayer requests for retroactive method changes consumes substantial examination resources and thereby impedes the IRS's enforcement efforts.

Summary of Process Steps

Identifying and Handling Claims for Changes in Accounting Methods
Process Steps
The steps will take you through the process of determining whether a claim is a request for a change in accounting method and how you should handle the claim if it is.

Step 1	Identify Taxpayer-Filed Claims
Step 2	Identify Requests for Method Changes
Step 3	Determine Current Method of Accounting
Step 4	Confirm Adoption of Current Method
Step 5	Consider Service-Initiated Examination Activity
Step 6	Process the Claim

Step 1: Identify Taxpayer-Filed Claims

Identifying and Handling Claims for Changes in Accounting Methods
Step 1
Determine whether the taxpayer filed a claim. Does the adjustment decrease taxable income and, on its own, result in a refund of previously paid tax?

Considerations	Resources
The Claims, Abatements and Audit Reconsiderations Knowledge Base (KB) provides the IRS's current guidance on claims. A claim may relate to any item of income, loss, exclusion, deduction, or credit involving a specific refund amount of tax. Once a taxpayer files its tax return and then believes the tax is incorrect, it may file a claim for refund. A claim can be formal, where the taxpayer uses an IRS form such as an amended tax return, or informal, where the taxpayer does not use an IRS form, but submits the claim to you in writing. Does the taxpayer's claim adjustment reduce taxable income and, on its own, result in a refund of tax previously paid? That is, absent any other factors or adjustments, would the adjustment result in a tax refund? ? **DECISION POINT:** Did the taxpayer file a claim (that is, an adjustment that decreases taxable income and, on its own, results in a refund of previously paid tax)? If the taxpayer filed a claim, go to Step 2. If the taxpayer did not file a claim but is requesting a change in accounting method that increases taxable income, see "Other Considerations / Impact to Audit" at the end of this practice unit and the Corporate/Business Issues & Credits Knowledge Base (KB), Change in Methods Book, Ch 5 -*Involuntary Change in Method (Service-Initiated).*	▪ IRC 6511(a) ▪ Claims, Abatements and Audit Reconsiderations Knowledge Base – IRS Virtual Library ▪ Corporate Business/Issues & Credits KB, Change in Methods Book, Ch 5 - *Involuntary Change in Method (Service-Initiated)*

Step 2: Identify Requests for Method Changes

Identifying and Handling Claims for Changes in Accounting Methods
Step 2
Determine whether the claim is a request for a change in accounting method. An adjustment that changes the timing of recognizing an item of income, gain, deduction, or loss is a change in accounting method.

Considerations	Resources
What is the item (issue) the taxpayer has requested an adjustment for? ▪ Identify the item that is the subject of the claim. Does the adjustment involve a change in the taxpayer's overall accounting method or the timing of recognizing an income or deduction item? ▪ Neither the Code nor the regulations define the term "method of accounting." In general, an accounting method is a set of rules under which a taxpayer determines when to include an item in income, or when to take a deduction for an item of expense, in determining taxable income. ▪ The term "method of accounting" includes not only a taxpayer's overall method of accounting, but also the accounting treatment of any material item. ▪ An overall method is a general method of accounting, such as the cash method or an accrual method. A material item is any item that involves the proper time for including the item in income or deducting the item. ▪ A method of accounting must involve timing. If an accounting practice for an item does not permanently affect the taxpayer's lifetime taxable income but does or could change the year in which taxable income is reported (or in which deductions are claimed), the accounting practice for the item involves timing and is therefore considered a method of accounting.	▪ IRC 446 ▪ Treas. Reg. 1.446-1 ▪ Rev. Proc. 91-31 ▪ Corporate/Business Issues & Credits KB, Change in Methods Book, Ch 1 – *Accounting Method Basics* ▪ Practice Unit – *Accounting Method Basics*

Back to Table of Contents

Step 2: Identify Requests for Method Changes (cont'd)

Identifying and Handling Claims for Changes in Accounting Methods
Step 2

Considerations	Resources
Examples of change in accounting method requests submitted as claim adjustments: ▪ A taxpayer submits a claim requesting a change to shorten the recovery period of a depreciable asset it placed in service 3 years ago. The item that is the subject of the claim is depreciation of the asset. The claim is requesting a change in the timing of deducting depreciation because a change to shorten the recovery period of an asset will decrease the time over which a taxpayer deducts the asset's depreciable basis. ▪ A taxpayer submits a claim requesting a change from deducting legal fees in the year paid to deducting legal fees paid within 8 ½ months of year-end under the recurring item exception to economic performance. The item that is the subject of the claim is accrued year-end legal fees. The claim is requesting a change in the timing of deducting legal fees because the change accelerates the deduction. ▪ A taxpayer submits a claim requesting to change its IRC 263A computation for inventory. It has erroneously been including 100% of officers' salaries in the computation of its absorption ratio. The item that is the subject of the claim is officers' salaries. The claim is requesting a change in the timing of deducting officers' salaries from deducting when the taxpayer sells the inventory to deducting currently under IRC 162. **DECISION POINT:** Is the claim a request for a change in accounting method? If the claim involves a change in accounting method, go to Step 3. If the claim does not involve a change in accounting method, go to Step 6.	

Step 3: Determine Current Method of Accounting

Identifying and Handling Claims for Changes in Accounting Methods
Step 3
Determine whether the current method of accounting is permissible (that is, a method of accounting that complies with the Code, regulations, and other published guidance, and therefore clearly reflects income).

Considerations	Resources
Is the taxpayer's current method of accounting used on the filed return in compliance with the Code, regulations, and other published guidance? ▪ This step is important because you do not have the authority to change a taxpayer's permissible method of accounting. For example, if a taxpayer used a permissible method of accounting on its filed return and then filed a claim to change to another permissible method of accounting, you do not have the authority to accept the claim and change the taxpayer's method. ▪ The Code provides that no method of accounting is permissible unless, in the opinion of the Commissioner, it clearly reflects income. ▪ Generally, the Commissioner deems a method of accounting that complies with the Code, regulations, and other published guidance to be a permissible method of accounting that clearly reflects income. If the method of accounting does not comply with the Code, regulations, and other published guidance, it is presumed to be an impermissible method. ▪ You must make a concerted effort to understand the taxpayer's accounting method used on the filed tax return for the item(s) in question. This determination may entail having the taxpayer walk you through transactions from start to finish, analyze journal entries for the transactions, and review other books and records.	▪ IRC 446(b) ▪ IRM 4.11.6.7.5 – *IRC 446(e) - Taxpayer Files Amended Return or Claim (Formal or Informal) to Make "Retroactive" Change in Accounting Method*

Identifying and Handling Claims for Changes in Accounting Methods
Step 3

Considerations	Resources
After you understand the taxpayer's transactions and accounting method for an item, you need to determine whether the taxpayer used a permissible or an impermissible method of accounting on its filed tax return. **DECISION POINT:** Is the taxpayer's current method of accounting used on its filed tax return permissible? If the taxpayer used an impermissible method of accounting on its filed return, go to Step 4. If the taxpayer used a permissible one, go to Step 6.	

Step 4: Confirm Adoption of Current Method

Identifying and Handling Claims for Changes in Accounting Methods
Step 4
Determine whether the taxpayer adopted the current method of accounting.

Considerations	Resources
Did the taxpayer adopt its current method of accounting? When and how did the taxpayer adopt it? ▪ This step is important because once a taxpayer adopts a method of accounting, it must obtain the Commissioner's consent to change to a different method. This generally entails the taxpayer filing a Form 3115 for a prospective change. ▪ A taxpayer adopts a permissible method for its overall method of accounting (for example, the cash or an accrual method) by using it to compute income on its first return. A taxpayer adopts a permissible method of accounting for a material item by treating the item properly on the first return that reflects the item. − Example: In 2019, the taxpayer installed and placed in service a new commercially available software package and incurred costs of developing software in the process of installation or conversion. On the 2019 tax return, the taxpayer treated all costs attributable to the development of software as capital expenditures. The taxpayer properly amortized the costs ratably over a period of 36 months from the placed in-service date. The taxpayer adopted a permissible method of accounting for its software development costs by using the method on its 2019 tax return.	▪ Treas. Reg. 1.446-1(e)(1) ▪ Rev. Rul. 90-38 ▪ Corporate/Business Issues & Credits KB, Change in Methods Book, Ch 1 – *Accounting Method Basics*

Step 4: Confirm Adoption of Current Method (cont'd)

Identifying and Handling Claims for Changes in Accounting Methods
Step 4

Considerations	Resources
▪ A taxpayer adopts an impermissible method for a material item by treating the item in the same way on two or more consecutively filed returns. − Example: In 2018, the taxpayer placed in service a new headquarters building and incorrectly treated the entire basis as land improvements (Asset Class 00.3) with a 15-year MACRS recovery period on its federal tax returns for 2018 and 2019. The taxpayer adopted an impermissible method of accounting for the building after treating the costs as land improvements on two consecutively filed tax returns (2018 and 2019 returns). ▪ Consecutively filed returns include all filed tax returns. That is, a taxpayer adopts an impermissible method of accounting with the filing of the second return using the same method, regardless whether the second year is before or after an examination year. − Example: Assume the same facts as prior example, except the taxpayer is under examination for its 2018 return. The taxpayer adopted an impermissible method of accounting for the building after treating the costs as land improvements on the 2018 and 2019 tax returns. The taxpayer adopted an impermissible method with the filing of its 2019 tax return, which is after the year under examination. ? **DECISION POINT:** Did the taxpayer adopt its current method of accounting? If the taxpayer adopted an impermissible method of accounting, go to Step 5. If the taxpayer did not adopt an impermissible method of accounting, go to Step 6.	

Step 5: Consider Service-Initiated Examination Activity

Identifying and Handling Claims for Changes in Accounting Methods
Step 5
Determine whether the method change request is the product of Service-initiated examination activities or substantially similar to an item for which the Service has initiated examination activities. This depends on whether the Service or the taxpayer raised the issue, or whether the claim issue is substantially similar to an issue that the Service raised.

Considerations	Resources
Is the request to change an accounting method a result of Service-initiated examination activity? This step is important in determining the proper action to take for a claim requesting a change from an impermissible method of accounting that the taxpayer adopted. In general, the Service should make a taxpayer-requested method change when the Service has raised the issue. However, there are additional considerations. ▪ Actions that rise to the level of Service-initiated examination activities depend on the extent of the activities undertaken for an issue. For example, did you submit detailed requests for information for an item, and did the taxpayer comply with such requests? On the other hand, did you simply question an item or issue a broad request for information? ▪ Consider all relevant facts and circumstances and use your judgment to determine whether the issue is a result of Service-initiated examination activity. ▪ Service-initiated examination activity specifically excludes activities that address a taxpayer claim (formal or informal) or a taxpayer-initiated method change (authorized or unauthorized).	▪ Rev. Proc. 2002-18 ▪ IRM 4.11.6.7.5 – *IRC 446(e) - Taxpayer Files Amended Return or Claim (Formal or Informal) to Make “Retroactive” Change in Accounting Method*

Step 5: Consider Service-Initiated Examination Activity (cont'd)

Identifying and Handling Claims for Changes in Accounting Methods
Step 5

Considerations	Resources
▪ As the examining agent, you determine the scope of an examination and have wide discretion in choosing what sort of examination activities to initiate. − Example of Service-initiated examination activity: For an examination of a 2019 tax return, you identify 15-year recovery property in the examination plan and issue an Information Document Request (IDR) asking for the tax depreciation schedule, invoices, and detailed descriptions of the taxpayer's 15-year property to determine whether the recovery period should be 39 years. When the taxpayer provides its response to the IDR, it identifies certain 15-year property that is actually 5-year property and requests a change to the shorter recovery period. Because you raised the issue of the proper recovery period of 15-year property, and requested and received detailed information regarding the assets, then the taxpayer's claim is the result of Service-initiated examination activities. Is the item substantially similar to an item for which the Service has initiated examination activities? ▪ If so, this item should be included in any proposed method change. See Step 6. Note that an item is substantially similar if the same subsection of the Code or regulations governs the item and relates to the same type of expenditure, income item, or property for which the Service has initiated examination of the item for the taxable period.	

Step 5: Consider Service-Initiated Examination Activity (cont'd)

Identifying and Handling Claims for Changes in Accounting Methods
Step 5

Considerations	Resources
▪ Imposing a method change for a substantially similar item generally does not require a substantial amount of additional audit resources. If you find that imposing the change would divert substantial resources, the item probably is not substantially similar. – Example of a Substantially Similar Item: You are examining a 2019 consolidated tax return. You examine X Subsidiary's 15-year recovery property placed in service in 2019. You identify that several items should have been 5-year recovery property and impose a change in accounting method. The taxpayer identifies several similar properties on subsidiaries W and Y that were incorrectly identified as 15-year recovery property. The taxpayer provides you with a list of the properties for each subsidiary and requests a change in accounting method to 5-year recovery property. Because the properties are substantially similar to the properties identified on X subsidiary, the Service should initiate a change in accounting method for subsidiaries W and Y. **DECISION POINT:** Is the change for the item a result of Service-initiated examination activity or substantially similar to an item for which the Service initiated examination activities? Go to Step 6.	

Step 6: Process the Claim

Identifying and Handling Claims for Changes in Accounting Methods
Step 6
Determine how to handle the claim. The results from Steps 1-5 determine the proper action to take on the claim.

Considerations	Resources
For each of the following scenarios, an example is included in the "Examples of the Process" section along with a summary of the applicable decision point responses. ▪ If a taxpayer's claim is not a request for a change in accounting method, you should address the claim as the correction of an error and include it in the Revenue Agent's Report (RAR). Review IRM 4.10.11, *Examination of Returns, Claims for Refund and Requests for Abatement,* to determine the proper treatment and processing of the claim. See Example 1 in the Examples of the Process section. ▪ If a taxpayer's claim requests a change from a permissible method of accounting to another permissible method, do not impose the method change in the RAR. The Service does not have the authority to change a taxpayer from one permissible method to another permissible method. Rather, refer the taxpayer to the voluntary method change procedures: taxpayer should file a Form 3115 to change its method on a prospective basis, that is, on a yet to be filed tax return. Review IRM 4.10.11, *Examination of Returns, Claims for Refund and Requests for Abatement,* to determine the proper treatment and processing of the claim. See Example 2 in the Examples of the Process section.	▪ Claims, Abatements and Audit Considerations Knowledge Base – IRS Virtual Library ▪ Rev. Proc. 2002-18 ▪ Rev. Proc. 2015-13 ▪ IRM 4.11.6 – *Examining Officer's Guide (EOG), Changes in Accounting Methods*

Step 6: Process the Claim (cont'd)

Identifying and Handling Claims for Changes in Accounting Methods
Step 6

Considerations	Resources
▪ If a taxpayer's claim is to change from an impermissible method of accounting that the taxpayer has not adopted (that is, it has not used the same impermissible method on two or more consecutively filed tax returns) to a permissible method of accounting, include the adjustment in the RAR. Review IRM 4.10.11, *Examination of Returns, Claims for Refund and Requests for Abatement*, to determine the proper treatment and processing of the claim. See Example 3 in the Examples of the Process section. ▪ If a taxpayer's claim is to change from an impermissible method of accounting that the taxpayer has adopted to a permissible method of accounting and the request is the result of Service-initiated examination activity, impose a change in accounting method using the Service-Imposed Method Change Issue Pro Forma Notice of Proposed Adjustment (NOPA) and include the adjustment in the RAR. See Example 4 in the Examples of the Process section. ▪ If a taxpayer's claim is to change from an impermissible method of accounting that the taxpayer has adopted, and the request is not a result of Service-initiated examination activity, do not impose the method change in the RAR. Rather, direct the taxpayer to file a Form 3115 to prospectively make the method change. Use the Taxpayer-Initiated Retroactive Method Change Issue Pro Forma NOPA to notify the taxpayer of the claim denial. Review IRM 4.10.11, *Examination of Returns, Claims for Refund and Requests for Abatement,* to determine the proper treatment and processing of the claim. See Example 5 in the Examples of the Process section.	▪ Pro Forma Notice of Proposed Adjustment - Service-Imposed Method Change Issue ▪ Pro Forma Notice of Proposed Adjustment - Taxpayer-Initiated Retroactive Method Change Issue

Step 6: Process the Claim (cont'd)

Identifying and Handling Claims for Changes in Accounting Methods
Step 6

Considerations	Resources
If the taxpayer does not agree with the claim disallowance and requests to go to Appeals, note on the Form 4665, *Report Transmittal,* that the Appeals Officer should contact the Appeals Change in Accounting Method Technical Specialist for assistance with the issue.	

Definitions

Identifying and Handling Claims for Changes in Accounting Methods
Description
▪ Adopting a Method of Accounting - A taxpayer adopts a method of accounting by using it consistently on its tax returns. In general, a taxpayer adopts a permissible method of accounting by using it on the first return that reflects the overall method or material item and adopts an impermissible method of accounting by using it on two or more consecutively-filed returns. Once adopted, a taxpayer must secure the Commissioner’s consent to change to a different method. ▪ Automatic Change in Accounting Method - A change described in the List of Automatic Changes (Rev. Proc. 2022-14 or successor) for which a taxpayer is eligible to request the Commissioner’s consent to make a change in accounting method under the automatic method change procedures (Rev. Proc. 2015-13 or successor). ▪ Change in Accounting Method (CAM) – A change in the overall plan of accounting or a change in the tax treatment of a material item. ▪ Claim - A taxpayer request for a refund of previously paid tax. In an examination, a claim can be a request for an adjustment that reduces taxable income and, on its own, would result in a refund of previously paid tax. ▪ Impermissible Method of Accounting - A method that does not comply with the Code, regulations, or other published guidance. The Service does not consider an impermissible method to clearly reflect income. ▪ Involuntary Method Change - A Service-initiated change in accounting method. ▪ Material Item - Any item of income or deduction, or gain or loss that involves the timing of recognition of the item. ▪ Method of Accounting - In general, a method of accounting is a set of rules used to determine when a taxpayer takes income and expenses into account for federal income tax purposes. ▪ Non-Automatic Change in Accounting Method - A change a taxpayer is not eligible to use the automatic method change procedures (Rev. Proc. 2015-13 or successor). ▪ Permanent Adjustment - A change to the tax treatment of an item that permanently changes a taxpayer’s lifetime taxable income. A permanent adjustment is not a change in accounting method. ▪ Permissible Method of Accounting - A method that is in accordance with the Code, regulations, or other published guidance. The Service presumes a permissible method of accounting to clearly reflect income.

Definitions (cont'd)

Identifying and Handling Claims for Changes in Accounting Methods
Description
▪ Present (Current) Method - The method the taxpayer is currently using on its tax returns. It is the method the taxpayer is requesting the Commissioner's consent to change, or the method the Service is changing. ▪ Proposed Method – The method of accounting the taxpayer is requesting the Commissioner's consent to change to or to which the Service is changing the taxpayer. ▪ Prospective Method Change - A change in accounting method effective on a yet to be filed tax return. It is generally a taxpayer's next filed tax return. ▪ Retroactive Method Change - A change in accounting method made on a previously filed taxable year rather than a prospective tax year. ▪ Timing Adjustment - A change to tax treatment that does not permanently change a taxpayer's lifetime taxable income but does or could change the taxable year in which the taxpayer takes the item into account in determining taxable income (that is, a change in method of accounting). ▪ Unauthorized Method Change - A taxpayer-initiated accounting method change that does not comply with all the provisions of the applicable revenue procedure. ▪ Voluntary Method Change - A taxpayer-initiated change in accounting method (automatic or non-automatic).

Examples of the Process

Identifying and Handling Claims for Changes in Accounting Methods

Description

Step 1	Step 2	Step 3	Step 4	Step 5	Step 6
Is Request a Claim?	Is Change a CAM?	Is Current Method Permissible?	Was Method Adopted?	Result of Exam-Initiated Activity?	Proper Actions
YES	NO	N/A	N/A	N/A	Include claim in examination scope. Allow or deny as appropriate. (See Example 1)
YES	YES	YES	N/A	N/A	Deny claim. Advise taxpayer to file a Form 3115 for prospective method change. (See Example 2)
YES	YES	NO	NO	N/A	Include the adjustment in the RAR. (See Example 3)
YES	YES	NO	YES	YES	Impose a Service-Initiated CAM to a permissible method. (See Example 4)
YES	YES	NO	YES	NO	Deny claim. Advise taxpayer to file a Form 3115 for prospective method change. (See Example 5)

Examples of the Process (cont'd)

Identifying and Handling Claims for Changes in Accounting Methods
Description
<u>Example 1: Taxpayer's Claim Is Not a Request for a Change in Accounting Method</u> Facts: A taxpayer under examination submits an adjustment, in writing, to reduce taxable income by $50,000. The taxpayer incorrectly included $50,000 of tax-exempt interest on its tax return in the examination year. <u>Step 1: Determine Whether the Taxpayer Filed a Claim</u> ▪ The requested adjustment, by itself, results in a decrease to taxable income and a refund of tax. It is an informal claim because the taxpayer did not use an IRS form. <u>Step 2: Determine Whether the Claim Is a Request for a Change in Accounting Method</u> ▪ The adjustment to tax-exempt interest does not affect the timing of when the taxpayer recognizes tax-exempt interest because it is a permanent exclusion from income. Therefore, the claim is not a request for a change in accounting method. <u>Step 3: Determine Whether the Current Method of Accounting Is a Permissible Method</u> ▪ Not applicable – This step is not relevant because the claim is not a request for a change in accounting method. <u>Step 4: Determine Whether the Taxpayer Adopted the Current Method of Accounting</u> ▪ Not applicable – This step is not relevant because the claim is not a request for a change in accounting method. <u>Step 5: Determine Whether the Method Change Request is a Result of Examination-Initiated Activities</u> Determine whether the method change request is the product of Service-initiated examination activities or substantially similar to an item for which the Service has initiated examination activities. ▪ Not applicable – This step is not relevant because the claim is not a request for a change in accounting method.

Examples of the Process (cont'd)

Identifying and Handling Claims for Changes in Accounting Methods
Description
Example 1: Taxpayer's Claim Is Not a Request for a Change in Accounting Method (cont'd) Step 6: Determine How to Handle the Claim ▪ You should include the claim in the examination scope, address it as potential error correction, and allow or deny the claim as appropriate.

Examples of the Process (cont'd)

Identifying and Handling Claims for Changes in Accounting Methods
Description
Example 2: Taxpayer's Claim Requests a Change From a Permissible Method of Accounting to Another Permissible Method Facts: A retail taxpayer recognizes income from the sale of its gift cards when the customer redeems a gift card for financial reporting purposes, and when it sells the gift card (the full inclusion method) for tax purposes. The full inclusion method is a permissible method of accounting for advance payments, including gift card sales. The taxpayer has used this method for several years. During the 2019 examination, the taxpayer submits a Form 1120X to change its method of accounting from the full inclusion method to the one-year deferral method allowed in IRC 451(c). The taxpayer qualifies to use the one-year deferral method. The adjustment results in a decrease to taxable income. Step 1: Determine Whether the Taxpayer Filed a Claim ▪ The requested adjustment decreases taxable income. Absent other factors, it results in a refund of taxes and qualifies as a claim. It is a formal claim because the taxpayer submitted it on an amended tax return. Step 2: Determine Whether the Claim Is a Request for a Change in Accounting Method ▪ The claim involves a change in accounting method because it requests a change in when the taxpayer recognizes gift card income from the full inclusion method to recognizing income under the one-year deferral method. It involves timing. Step 3: Determine Whether the Current Method of Accounting is a Permissible Method ▪ The full inclusion method complies with IRC 451 and is a permissible method of accounting for gift card sales. Step 4: Determine Whether the Taxpayer Adopted the Current Method of Accounting ▪ Not applicable – This step is not relevant because the taxpayer is using a permissible method of accounting for gift card sales.

Examples of the Process (cont’d)

Identifying and Handling Claims for Changes in Accounting Methods
Description
Example 2: Taxpayer’s Claim Requests a Change From a Permissible Method of Accounting to Another Permissible Method (cont’d) Step 5: Determine Whether the Method Change Request is a Result of Examination-Initiated Activities Determine whether the method change request is the product of Service-initiated examination activities or substantially similar to an item for which the Service has initiated examination activities. ▪ Not applicable – This step is not relevant because the taxpayer is using a permissible method of accounting for gift card sales. Step 6: Determine How to Handle the Claim ▪ The taxpayer is requesting a retroactive change in accounting method from one permissible method to another permissible method. The Service does not have the authority to change a taxpayer from a permissible method. You should deny the taxpayer’s claim requesting a retroactive change to its permissible accounting method for gift card sales. You should use the Taxpayer- Initiated Retroactive Method Change Issue Pro Forma NOPA to notify the taxpayer of the claim denial. The taxpayer may follow the voluntary method change procedures and file a Form 3115 prospectively (on a yet to be filed tax return) to change to the one-year deferral method under IRC 451(c).

Examples of the Process (cont'd)

Identifying and Handling Claims for Changes in Accounting Methods
Description
Example 3: Taxpayer's Claim Requests a Change From an Impermissible Method of Accounting the Taxpayer Has Not Adopted (The taxpayer has not used the same impermissible method on two or more consecutively filed tax returns) Facts: In 2020, the examination year and the most recently filed tax return, the taxpayer impermissibly capitalized an expense. This is the first year the taxpayer incurred this item. The taxpayer requested an adjustment, in writing, to deduct the expenses. Step 1: Determine Whether the Taxpayer Filed a Claim ▪ The requested adjustment decreases taxable income. Absent other factors, it results in a refund of taxes and qualifies as a claim. It is an informal claim because the taxpayer submitted it, in writing, but it was not on an amended tax return. Step 2: Determine Whether the Claim is a Request for a Change in Accounting Method ▪ The claim involves a change in accounting method because it requests a change in when the taxpayer deducts an expense. It involves timing. Step 3: Determine Whether the Current Method of Accounting Is a Permissible Method ▪ You determine capitalizing the expense is an impermissible method of accounting, and the proper treatment is to deduct the item in the year incurred. Step 4: Determine Whether the Taxpayer Adopted the Current Method of Accounting ▪ Because capitalizing this expense is an impermissible method of accounting, a taxpayer adopts the method by using it on two or more consecutively filed tax returns. In this case, the taxpayer only filed one tax return using the impermissible method, so the taxpayer has not adopted the method.

Examples of the Process (cont'd)

Identifying and Handling Claims for Changes in Accounting Methods
Description
Example 3: Taxpayer's Claim Requests a Change From an Impermissible Method of Accounting the Taxpayer Has Not Adopted (cont'd) Step 5: Determine Whether the Method Change Request is a Result of Examination-Initiated Activities Determine whether the method change request is the product of Service-initiated examination activities or substantially similar to an item for which the Service has initiated examination activities. ▪ Not applicable – This step is not relevant because the taxpayer has not adopted the impermissible method of accounting. Step 6: Determine How to Handle the Claim ▪ The taxpayer is requesting a change from capitalizing to deducting an item. Because the taxpayer did not adopt the impermissible method of accounting, you should include the adjustment in the RAR.

Examples of the Process (cont'd)

Identifying and Handling Claims for Changes in Accounting Methods
Description
Example 4: Taxpayer's Claim Requests Is a Change From an Adopted Impermissible Method and the Change Request Is the Result of Service-Initiated Examination Activities Facts: During a 2017 examination, you analyzed the classification of assets in account 30xx, 15-year property, for Subsidiary X that were placed in service in 2016 and determined that the taxpayer should have depreciated 20 assets in that account using a 39-year recovery period. You will impose a change in accounting method to change the recovery period for the 20 assets from the impermissible 15-year recovery period to a permissible 39-year recovery period. The taxpayer provides a written request to change the recovery period for five other assets in the same account, 30xx, 15-year property, for Subsidiary X, from a 15-year recovery period to a 5-year recovery period. The taxpayer placed the five assets in service in 2016. The change from a 15-year recovery period to a 5-year recovery period decreases taxable income. Step 1: Determine Whether the Taxpayer Filed a Claim ▪ The requested adjustment decreases taxable income. Absent other factors, it results in a refund of taxes and qualifies as a claim. It is an informal claim because the taxpayer submitted it, in writing, but it was not on an amended tax return. Step 2: Determine Whether the Claim is a Request for a Change in Accounting Method ▪ The claim involves a change in accounting method because it requests a change in the timing of depreciation deductions for the assets. A change in recovery period is a change in accounting method per Treas. Reg. 1.446-1(e)(2)(ii)(d)(2)(i). Step 3: Determine Whether the Current Method of Accounting Is a Permissible Method ▪ The 15-year recovery period is incorrect; the correct recovery period is 5 years for the five assets in question. Therefore, the taxpayer is using an impermissible method of accounting for the assets.

Examples of the Process (cont'd)

Identifying and Handling Claims for Changes in Accounting Methods
Description
Example 4: Taxpayer's Claim Requests Is a Change From an Adopted Impermissible Method and the Change Request Is the Result of Service-Initiated Examination Activities (cont'd) Step 4: Determine Whether the Taxpayer Adopted the Current Method of Accounting ▪ The taxpayer used the same incorrect method of accounting (that is, the wrong recovery period) on its 2016 and 2017 tax returns. A taxpayer adopts an impermissible method by using it on two or more consecutively filed tax returns. The taxpayer adopted the impermissible method of accounting for these assets when it filed its 2017 tax return. Step 5: Determine Whether the Method Change Request is a Result of Examination-Initiated Activities Determine whether the method change request is the product of Service-initiated examination activities or substantially similar to an item for which the Service has initiated examination activities. ▪ The items identified by the taxpayer are substantially similar to assets you analyzed because all the assets are in the same account, 30xx, 15-year property for Subsidiary X. Step 6: Determine How to Handle the Claim ▪ Because the items are substantially similar to assets you analyzed, you should allow the taxpayer's informal claim. You should impose a Service-initiated change in accounting method to a permissible method for the five assets from a 15-year recovery period to a 5-year recovery period using the Service-Imposed Method Change Issue Pro Forma NOPA.

Examples of the Process (cont'd)

Identifying and Handling Claims for Changes in Accounting Methods
Description
Example 5: Taxpayer's Claim Requests a Change From an Adopted Impermissible Method of Accounting to a Permissible Method, and It Is Not a Result of Service-Initiated Examination Activity Facts: During a 2018 examination, a taxpayer reviews its fixed asset tax depreciation schedule and discovers it has been using an incorrect 39-year recovery period for depreciating one certain asset since 2017. The taxpayer advises you that it made an error and requests, in writing, that you allow a change to the correct 15-year recovery period in 2018. The taxpayer is not applying the 2020 final regulations under IRC 168(k), the 2019 final regulations under IRC 168(k), and/or the 2019 proposed regulations under IRC 168(k). You are not examining depreciation. Step 1: Determine Whether the Taxpayer Filed a Claim ▪ The requested adjustment decreases taxable income and, on its own, results in a refund of taxes. It is an informal claim because the taxpayer submitted it, in writing, but it was not on an amended tax return. Step 2: Determine Whether the Claim is a Request for a Change in Accounting Method ▪ The claim involves a change in accounting method because it requests a change in the timing of depreciation deductions for an asset. A change in recovery period is a change in accounting method per Treas. Reg. 1.446-1(e)(2)(ii)(d)(2)(i). Step 3: Determine Whether the Current Method of Accounting Is a Permissible Method ▪ The 39-year recovery period is incorrect; the correct recovery period is 15 years for the asset in question. Therefore, the taxpayer is using an impermissible method of accounting for the asset. Step 4: Determine Whether the Taxpayer Adopted the Current Method of Accounting ▪ The taxpayer used the same incorrect method of accounting (that is, the wrong recovery period) on its 2017 and 2018 tax returns. A taxpayer adopts an impermissible method by using it on two or more consecutively filed tax returns. The taxpayer adopted the impermissible method of accounting for this asset when it filed its 2018 tax return.

Back to Table of Contents

Examples of the Process (cont'd)

Identifying and Handling Claims for Changes in Accounting Methods
Description
<u>Example 5: Taxpayer's Claim Requests a Change From an Adopted Impermissible Method of Accounting to a Permissible Method, and It Is Not a Result of Service-Initiated Examination Activity (cont'd)</u> <u>Step 5: Determine Whether the Method Change Request is a Result of Examination-Initiated Activities</u> Determine whether the method change request is the product of Service-initiated examination activities or substantially similar to an item for which the Service has initiated examination activities. ▪ The taxpayer's request is not the result of Service-initiated examination activity because you are not examining depreciation. <u>Step 6: Determine How to Handle the Claim</u> ▪ The taxpayer is requesting a retroactive change in accounting method from an impermissible method to a permissible method for the asset. Because the issue is not a result of Service-initiated examination activity and is not substantially similar to an examination issue, you should deny the taxpayer's claim requesting to retroactively change its depreciation method for the asset. You should use the Taxpayer- Initiated Retroactive Change Issue Pro Forma NOPA to notify the taxpayer of the claim denial. The taxpayer may follow the voluntary method change procedures and file a Form 3115 prospectively (on a yet to be filed return) to change its method of accounting.

Identifying and Handling Claims for Changes in Accounting Methods	
Considerations	**Resources**
! **CAUTION:** Requests for changes that increase a taxpayer's income: A taxpayer-requested retroactive change in accounting method may not always be taxpayer-favorable. Regardless whether the taxpayer-requested retroactive method change decreases or increases income, do not make a taxpayer-initiated retroactive change in accounting method because a taxpayer under examination should not obtain more advantageous terms and conditions than a taxpayer not under examination. An exception, however, exists if the request is a result of Service-initiated exam activity. (See Step 5). Carefully consider the reasons for a taxpayer-requested government-favorable retroactive method change. For example, a taxpayer with expiring credits may request a retroactive change in accounting method that increases taxable income to use its expiring carryforwards. However, a taxpayer who is not under examination would be required to file a Form 3115 and change its method prospectively, and its carryforwards might expire before the next-filed return year.	▪ IRC 446 ▪ Treas. Reg. 1.446-1 ▪ IRM 4.11.6 - *Examining Officer's Guide (EOG), Changes in Accounting Methods* ▪ Corporate/Business Issues & Credits KB, Methods of Accounting and Timing, Change in Methods, Ch 1 – *Accounting Method Basics*
! **CAUTION:** Change in Service's position: Where the Service has changed its position for a particular method of accounting (for example, where it recognizes the permissibility of a method that it previously viewed as impermissible), a taxpayer may submit a claim requesting a change to the previously disputed method in the year(s) under examination. The Service recognizes such circumstances as "unique and extraordinary." To avoid disparate treatment between taxpayers under examination and those not under examination, the National Office Chief Counsel should make this determination. Examiners may contact the Methods of Accounting and Timing Practice Network for assistance.	

Index of Referenced Resources

Identifying and Handling Claims for Changes in Accounting Methods
IRC 446
IRC 6511(a)
Treas. Reg. 1.446-1
Rev. Rul. 90-38
Rev. Proc. 91-31
Rev. Proc. 2002-18
Rev. Proc. 2015-13 (or successor)
Rev. Proc. 2022-14 (or successor)
IRM 4.10.11 – *Examination of Returns, Claims for Refund and Requests for Abatement*
IRM 4.11.6 – *Examining Officer's Guide (EOG), Changes in Accounting Methods*
IRM 4.11.6.7.5 – *IRC 446(e) – Taxpayer Files Amended Return or Claim (Formal or Informal) to Make "Retroactive" Change in Accounting Method*
Corporate/Business Issues & Credits KB, Change in Methods Book, Ch 1 – *Accounting Method Basics*
Corporate/Business Issues & Credits KB, Change in Methods Book, Ch. 4 – *Voluntary Change in Method (Taxpayer-Initiated)*
Corporate/Business Issues & Credits KB, Change in Methods Book, Ch. 5 – *Involuntary Change in Method (Service-Initiated)*
Claims, Abatements and Audit Reconsiderations Knowledge Base

Back to Table of Contents

Index of Referenced Resources (cont'd)

Identifying and Handling Claims for Changes in Accounting Methods
Pro Forma Notice of Proposed Adjustment – Service-Imposed Method Change Issue
Pro Forma Notice of Proposed Adjustment – Taxpayer-Initiated Retroactive Method Change Issue
Form 3115 - *Application for Change in Accounting Method*
Capital One Financial Corp. v. C.I.R., 659 F.3d 316 (4th Cir. 2011)
Pacific National Co. v. Welch, 304 U.S. 191 (1938)

Training and Additional Resources

Identifying and Handling Claims for Changes in Accounting Methods	
Type of Resource	**Description(s)**
Other Training Materials	▪ Accounting Method Changes PPT – 2019 Centra ▪ Identifying and Handling Claims for Accounting Method Changes PPT 2017-10

Glossary of Terms and Acronyms

Term/Acronym	Definition
CAM	Change in Accounting Method
IRM	Internal Revenue Manual
KB	Knowledge Base
NOPA	Notice of Proposed Adjustment
RAR	Revenue Agent Report

Index of Related Practice Units

Associated UIL(s)	Related Practice Unit
446.00-00	*Accounting Method Basics*