



# MANUAL TRANSMITTAL

Department of the Treasury  
Internal Revenue Service

4.11.6

FEBRUARY 9, 2021

## EFFECTIVE DATE

(02-09-2021)

## PURPOSE

- (1) This transmits revised IRM 4.11.6, Examining Officers Guide (EOG), Changes in Accounting Methods.

## MATERIAL CHANGES

- (1) Renamed IRM 4.11.6.1, References for Changes in Accounting Methods, to Program Scope and Objectives to conform to the rules described in IRM 1.11.2.2.5, Address Management and Internal Controls. Added new subsections for Background, Authority, Roles and Responsibilities, and Related Resources and rearranged content accordingly.
- (2) IRM 4.11.6.1.2, Authority: Added Rev. Proc. 2017-30, 2018-31 and 2019-43.
- (3) Editorial changes made throughout.

## EFFECT ON OTHER DOCUMENTS

This IRM supersedes IRM 4.11.6 dated February 15, 2017.

## AUDIENCE

Examination personnel in SB/SE and LB&I.

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4.11.6

Changes in Accounting Methods

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4.11.6.1  
(02-09-2021)  
**Program Scope and Objectives**

- (1) **Purpose** : This IRM serves as a reference guide for procedures on changes in accounting methods. It acts as an index, providing guidance for examination activity and refers the reader to supporting references. It is not intended to be an exclusive research tool.
- (2) **Audience** : Examination personnel in LB&I and SB/SE.
- (3) **Policy Owner** : LB&I Assistant Deputy Commissioner Compliance Integration.
- (4) **Program Owner** : Methods of Accounting and Timing Practice Network.
- (5) **Primary Stakeholders** : Examination personnel in LB&I and SB/SE.
- (6) **Program Goals** : The goal of this program is to provide guidance to examiners with changes in accounting method issues.

4.11.6.1.1  
(02-09-2021)  
**Background**

- (1) Neither the Code nor the regulations specifically define the term “method of accounting.” In general, an accounting method is a set of rules used to determine when and how a taxpayer takes income and expenses into account for federal income tax purposes.

4.11.6.1.2  
(02-09-2021)  
**Authority**

- (1) The following Internal Revenue Code and regulation sections govern changes in accounting methods:
  - IRC 446 - General Rule for Methods of Accounting
  - IRC 481 - Adjustments Required by Changes in Method of Accounting
  - Treas. Regs. 26 CFR 1.446-1 et seq, 26 CFR 1.481-1 and 26 CFR 1.481-2
  - Rev. Rul. 90-38, 1990-18 I.R.B. 7 - Although the Commissioner is authorized to consent to a retroactive accounting method change, a taxpayer does not have a right to a retroactive change, regardless of whether the change is from a permissible or impermissible method.
  - Rev. Proc. 97-27, 1997-21 I.R.B. 10 - This advance consent (voluntary change) revenue procedure provides the general procedures under Treas. Reg. 1.446-1(c) for obtaining the consent of the Commissioner of Internal Revenue to change a method of accounting for federal income tax purposes. Rev. Proc. 97-27 was modified by Rev. Proc. 2002-19, Rev. Proc. 2007-67 and Rev. Proc. 2009-39, and superseded by Rev. Proc. 2015-13.
  - Rev. Proc. 2002-18, 2002-13 I.R.B. 678 - This revenue procedure provides the procedures under IRC 446(b) and Treas. Reg. 1.446-1(b) for Service-imposed (involuntary) changes in accounting methods. This revenue procedure also provides the procedures that the Service (other than examiners) may use for accounting method issues resolved on a non-accounting method change basis. This revenue procedure is effective for examiner’s reports issued on or after July 1, 2002.
  - Rev. Proc. 2002-19, 2002-13 I.R.B. 696 - This revenue procedure modified Rev. Proc. 97-27 and Rev. Proc. 2002-9 to provide procedures for obtaining consent for a change in accounting method. This procedure introduced a method change without audit protection for an “issue pending” for a tax year under examination and shortened the spread period for a taxpayer-favorable (negative) IRC 481(a) adjustment.
  - Rev. Proc. 2007-67, 2007-48 I.R.B. 1072 - This revenue procedure allowed taxpayers, under certain conditions, to request to revise the

year of change for a Form 3115, *Application for Change in Accounting Method*, that is pending with the National Office. It also modified the period for taking into account a net positive IRC 481(a) adjustment when the Commissioner approves the taxpayer's request to revise the year of change.

- Rev. Proc. 2008-52, 2008-36 I.R.B. 587 - This revenue procedure superseded Rev. Proc. 2002-9 to provide procedures for obtaining automatic consent for specifically identified change in accounting methods.
- Rev. Proc. 2009-39, 2009-38 I.R.B. 371 - This revenue procedure modified Rev. Proc. 97-27 and Rev. Proc. 2008-52, and was modified by Rev. Proc. 2011-14, to provide procedures for obtaining consent for a change in accounting method.
- Rev. Proc. 2011-14, 2011-4 I.R.B. 330 - This automatic consent (voluntary change) revenue procedure provided the procedures by which a taxpayer could obtain automatic consent to change the methods of accounting described in the Appendix. Pronouncements issued subsequent to the publication of Rev. Proc. 2011-14 that refer to this revenue procedure have modified its Appendix to include other methods of accounting. Rev. Proc. 2011-14 was superseded by Rev. Proc. 2015-13 and the list of automatic method changes included separately in Rev. Proc. 2015-14.
- Rev. Proc. 2015-13, 2015-5 I.R.B. 419 - This revenue procedure updates and revises the procedures by which a taxpayer may obtain non-automatic consent and automatic consent to change a method of accounting. It modified the procedures for taxpayers under examination by replacing the consent of director and issue pending provisions with broad eligibility rules. In conjunction, it modified the IRC 481(a) adjustment period and audit protections.
- Rev. Proc. 2015-14, 2015-5 I.R.B. 450 - This revenue procedure provides the first separate list of automatic method changes. Pronouncements issued subsequent to its publication have modified it to include additional automatic method changes.
- Rev. Proc. 2016-29, 2016-21 I.R.B. 880 - This revenue procedure updates and modifies the list of automatic method changes in Rev. Proc. 2015-14. Pronouncements issued subsequent to its publication have modified it to include additional automatic method changes.
- Rev. Proc. 2017-30, 2017-17 I.R.B. 1131 - This revenue procedure updates and modifies the list of automatic method changes in Rev. Proc. 2016-29. Pronouncements issued subsequent to its publication have modified it to include additional automatic method changes.
- Rev. Proc. 2018-31, 2018-22 I.R.B. 637 - This revenue procedure updates and modifies the list of automatic method changes in Rev. Proc. 2017-30. Pronouncements issued subsequent to its publication have modified it to include additional automatic method changes.
- Rev. Proc. 2019-43, 2019-48 I.R.B. 1107 - This revenue procedure updates and modifies the list of automatic method changes in Rev. Proc. 2018-31. Pronouncements issued subsequent to its publication have modified it to include additional automatic method changes.

4.11.6.1.3  
(02-09-2021)

**Roles and  
Responsibilities**

- (1) For responsibilities of LB&I teams, in general, see IRM 4.46.1.1.3, Roles and Responsibilities.

4.11.6.1.4  
(02-09-2021)  
**Related Resources**

- (1) The following are related resources:
  - *IRS Virtual Library - Methods of Accounting and Timing Shelf*
  - IRM 4.2.3 - Examination Techniques
  - Publication 538 (Rev. 01/2019) - Accounting Periods and Methods

4.11.6.2  
(02-09-2021)  
**General Principles for  
Changes in Accounting  
Methods**

- (1) A taxpayer must compute taxable income under the method of accounting regularly used in keeping its books. However, the regulations allow variations between financial and tax reporting where the method of accounting used for tax complies with the requirements of the IRC and the regulations and provides a clear reflection of taxable income (e.g., depreciation). The taxpayer must be able to reconcile any variations between book and tax accounting.
- (2) **Clear Reflection of Income:** If a taxpayer has not used a method of accounting regularly or if the method employed does not clearly reflect income, the Service will make the computation under a method that, in the opinion of the Commissioner, clearly reflects income. The Commissioner will not regard a method of accounting as clearly reflecting income unless the taxpayer treats all items of income and expenses with reasonable consistency. However, consistency alone is not the sole criteria for an accurate determination of income. Key concepts in determining what constitutes a method of accounting are (1) timing and (2) consistency.
- (3) **Timing:** 26 CFR 1.446-1(e)(2)(ii)(a) provides that a change in the method of accounting includes a change in the overall plan of accounting, as well as a change in the treatment of any material item. A material item is any item that involves the proper time for inclusion of the item in income or the taking of a deduction. In determining whether a practice involves the proper time for inclusion of an item in income or taking of a deduction, the relevant question is generally whether the practice permanently changes the amount of taxable income over a taxpayer's lifetime. If the practice does not permanently change taxable income over a taxpayer's lifetime, but does or could change the taxable year in which a taxpayer reports taxable income, it involves timing and is therefore a method of accounting. See Rev. Proc. 91-31. Generally, if the issue involves *when* an item is deductible or included in income, as opposed to *whether* an item is deductible or included in income, the issue involves timing, and may be a method of accounting.
- (4) **Consistency:** Treasury Regulation 1.446-1(e)(2)(ii)(a) further provides that although a method of accounting may exist without a pattern of consistent treatment of an item, a method of accounting is not established 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 Treas. Reg. 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.
- (5) A change in the characterization of an item may 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: *Diebold, Inc. v. United States*, 16 Cl. 193 aff'd. 891 F.2d 1579 (Fed. Cir. 1989) cert. denied 498 U.S. 823 (1990) (inventory to capital asset); *Pacific Enterprises v. Commissioner*, 101 T.C. 1 (1993) ("working gas" (inventory) to "cushion gas" (capital asset)); *Humphrey, Farrington & McClain v. Commissioner*, T.C. Memo. 2013-23 (advanced litigation expenses from deductible business expense to loans).

- (6) **Errors and Changes in Underlying Facts:** 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). Likewise, a change in method of accounting does not include a change in treatment resulting from a change in underlying facts. See Treas. Reg. 1.446-1(e)(2)(ii)(b): *Huffman v. Commissioner*, 126 T.C. 322. 343-345 (2006). aff'd. 518 F.3d 357 (6th Cir. 2008) (mathematical error); *Wayne Bolt & Nut Co., v. Commissioner*, 93 T.C. 500, 501-511 (1989) (posting error); *ESCO Corp. v. United States*, 750 F.2d 1466, 1470 (9th Cir. 1985) (change in underlying facts).
- (7) The following is a non-exclusive list of accounting method issue areas commonly encountered by examiners:
- Capitalization issues – IRC 263(a) and IRC 263A relative to inventory, tangible assets and intangible assets
  - Accounting for liabilities that involve timing – IRC 461
  - Accounting for when income is recognized – IRC 451
  - Depreciation method change issues involving changes in recovery periods, conventions, safe-harbor methods, or additional first-year depreciation - Treas. Reg. 1.446-1(e)(2)(ii)(d). (See Chief Counsel Notice 2004-007, Chief Counsel Notice 2004-024 and field guidance for depreciation changes posted on the *IRS Virtual Library -Methods of Accounting and Timing Shelf*).
  - Inventory valuation issues including LIFO inventory – IRC 471 and IRC 472
  - Accrual to cash (and vice versa) – IRC 448
  - Accounting for long-term contracts – IRC 460

#### 4.11.6.3 (05-13-2005)

#### **Adoption of a Method of Accounting**

- (1) A taxpayer filing its first return may adopt any permissible method of accounting. See 26 CFR 1.446-1(e)(1). Once the taxpayer adopts a proper method of accounting by filing its return using such method, it may not adopt a different method of accounting by the filing of an amended return.
- (2) However, a taxpayer filing its first return using an improper method of accounting may change to a proper method by the filing of an amended return. The taxpayer **MUST** file the amended return prior to the filing of the next year's return. See Rev. Rul. 72-491, 1972-2 C.B. 104.
- (3) Two returns filed for consecutive years using an improper method establishes a method of accounting from which consent to change is required. A taxpayer may not file amended returns to change such method. See Rev. Rul. 90-38.

- 4.11.6.4  
(02-15-2017)  
**Requirement to Secure Consent to Make a Method Change**
- (1) IRC 446(e) and Treas. Reg. 1.446-1(e) state that, except as otherwise provided, a taxpayer must secure the consent of the Commissioner before changing from an “adopted” or “established” method of accounting for federal income tax purposes. Treas. Reg. 1.446-1(e)(3)(i) requires that, in order to obtain the Commissioner’s consent to make a method change, a taxpayer must file a Form 3115, Application for Change in Accounting Method, during the taxable year in which the taxpayer desires to make the proposed change. See also Rev. Proc. 2015-13 , § 6.03.
  - (2) Unless specifically authorized by the Commissioner, a taxpayer may not make a retroactive change in method of accounting, regardless of whether the change is from a permissible or an impermissible method. See Rev. Rul. 90-38.
- 4.11.6.5  
(02-15-2017)  
**IRC 481 and Cut-off Method**
- (1) Whenever the Service imposes, or a taxpayer initiates, a change in accounting method, there is a possibility for duplication or omission of income or deductions relating to transactions occurring in a year prior to the year of change. A change in accounting method requires either an IRC 481(a) adjustment or a change using the cut-off method. For Service imposed method changes, if the IRC 481(a) adjustment is substantial, IRC 481(b) may limit the tax.
- 4.11.6.5.1  
(02-15-2017)  
**IRC 481(a) Concept**
- (1) A change in method of accounting generally requires an adjustment under IRC 481(a) to prevent duplication or omission of income or deductions when the taxpayer computes its taxable income 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 IRC 481(a) is applied, income for the taxable years preceding the year of change must be determined under the method of accounting that was then employed, and the new method of accounting determines the income for the year of change and the subsequent taxable years as if the new method had always been used.
- 4.11.6.5.2  
(02-15-2017)  
**IRC 481(a) Adjustments**
- (1) A change in accounting method requires the computation of an IRC 481(a) adjustment as of the beginning of the taxable year for which the method is being changed (year of change). Simply stated, the adjustment represents the cumulative difference (without regard to the statute of limitations) between the present and proposed methods. The IRC 481(a) adjustment may increase income (positive adjustment) or decrease income (negative adjustment). In addition to the following example, see Exhibit 4.11.6-1 for a more detailed example of computing an adjustment under IRC 481(a).
- Example:** A taxpayer that is not required to maintain 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 IRC 481(a) adjustment of \$20,000 (\$120,000 accounts receivable less \$100,000 accounts payable) is required because of the change. If not for the IRC 481(a) adjustment, under the new method, the taxpayer would never recognize the \$120,000 accounts receivable, and it would never deduct the \$100,000 of accounts payable, as of the beginning of the year of change.

4.11.6.5.3  
(02-15-2017)  
**Spread Periods for IRC  
481(a) Adjustments**

- (1) A net positive IRC 481(a) adjustment increases income and is often referred to as a “government-favorable” adjustment. A net negative IRC 481(a) adjustment decreases income and may be referred to as a “taxpayer-favorable” adjustment. When a taxpayer uses the voluntary method change procedures or a regulation provision, it generally takes a net negative IRC 481(a) adjustment into account in the year of change. A taxpayer generally takes a net positive IRC 481(a) adjustment into account over four years (year of change and next three taxable years). See also IRM 4.11.6.6.4.1. When a taxpayer under examination requests consent for a voluntary change under Rev. Proc. 2015-13 or successors, it takes a net positive IRC 481(a) adjustment into account over two years, unless one of the following exceptions applies. See Rev. Proc. 2015-13, § 7.03(3)(b):

- Change filed in the three-month window (Rev. Proc. 2015-13, § 8.02(1)(a)),
- Change filed in a 120-day window (Rev. Proc. 2015-13, § 8.02(1)(b)),
- Present method not before the director (Rev. Proc. 2015-13, § 8.02(1)(c)),
- New member of a consolidated group in Compliance Assurance Process (CAP) (Rev. Proc. 2015-13, § 8.02(1)(d)).

A taxpayer may elect, on Form 3115, to have a one-year IRC 481(a) adjustment period, if the taxpayer’s positive IRC 481(a) adjustment is less than \$50,000. See Rev. Proc. 2015-13, § 7.03(3)(c).

When the Service imposes a method change (involuntary method change) as a result of an examination, it generally takes the entire net positive or negative IRC 481(a) adjustment into account in the year of change. See Rev. Proc. 2002-18, § 5.04(3).

4.11.6.5.4  
(02-15-2017)  
**Mandatory IRC 481(b)  
Tax Limitation  
Computation**

- (1) When the Service imposes a method change (involuntary method change) and the entire amount of the adjustment is taken into account in the year of change, it is mandatory to apply IRC 481(b) when the net positive IRC 481(a) adjustment is in excess of \$3,000. For the taxable year of change, IRC 481(b) provides a limitation on the tax attributable to the adjustments required under IRC 481(a) and 26 CFR 1.481-1. The tax limitation is only applicable to tax under Chapter 1 of the Internal Revenue Code. The following special rules apply for flow through entities under 26 CFR 1.481-2(c)(5).
- a. S corporation - When the service changes an S corporation’s method of accounting, it makes the adjustments required by IRC 481(a) on the S corporation’s return. However, the limitations on tax under IRC 481(b) apply to the individual shareholders. IRC 481(b) applies to a shareholder whose taxable income is increased by more than \$3,000 as a result of an IRC 481(a) adjustment to the corporation’s ordinary income.
  - b. Partnerships - When the service changes a partnership’s method of accounting, it makes the adjustments required by IRC 481(a) on the partnership’s return. However, the limitations on tax under IRC 481(b) apply to the individual partners. IRC 481(b) applies to a partner whose taxable income is increased by more than \$3,000 as a result of an IRC 481(a) adjustment to the partnership’s ordinary income.
- (2) The increase to income tax attributable to the IRC 481(a) adjustment is generally limited to the lesser of:

- a. Tax attributable to the IRC 481(a) adjustment taken into account entirely in the year of change; or
  - b. Tax attributable to the IRC 481(a) adjustment taken into account under a hypothetical three-year ratable spreadback (year of change and the two (2) preceding tax years) if the taxpayer used the prior method in the two (2) taxable years preceding the year of change.
- (3) If the taxpayer establishes the taxable income (under the new method) for one or more taxable years consecutively preceding the year of change, the tax amount resulting from 4.11.6.5.4(2) above is further limited to the tax attributable to a specific allocation of the IRC 481(a) amount to those consecutive source years.
  - (4) If IRC 481(b) limits the tax, the Service treats the difference between regularly computed tax and limited tax as a tax credit in the Revenue Agent Report (RAR) for the year of change.
  - (5) See Exhibit 4.11.6-2 for an example of the tax computation required under IRC 481(b)(1).

4.11.6.5.5  
(02-15-2017)  
**Method Change Using  
the Cut-off Method**

- (1) The Commissioner may determine that certain changes in method of accounting will be made without an IRC 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 taken into account under the new method of accounting. Any items arising before the year of change (or other operative date) continue to be taken into account under the taxpayer's former method of accounting. The cut-off method does not duplicate or omit any amounts from income; therefore, an IRC 481(a) adjustment is not necessary or required. The cut-off method may be available in a taxpayer-initiated method change (e.g., a change in the tax treatment of IRC 174 costs), but an examiner should make a method of accounting change using a cut-off method generally only where specifically allowed or required by statute, regulation or by the Commissioner in published guidance for the year of change.

4.11.6.6  
(02-15-2017)  
**Procedures for  
Obtaining Consent to  
Change a Method of  
Accounting**

- (1) A taxpayer may use the following procedures to obtain the required consent to change its method of accounting:
  - a. Special procedures established by statutes, regulations or IRS publications
  - b. Automatic consent procedures (Rev. Proc. 2015-13 or successors)
  - c. Non-automatic consent procedures (Rev. Proc. 2015-13 or successors)
- (2) Exhibit 4.11.6-3 summarizes the differences between the non-automatic and the automatic consent procedures.
- (3) Exhibit 4.11.6-4 summarizes the citation for key terms and concepts used in the voluntary method change arena.

4.11.6.6.1  
(02-15-2017)  
**Special Procedures  
Established by Statute,  
Regulations or IRS  
Publications**

- (1) Normally, a taxpayer uses the general automatic or non-automatic consent procedures (Rev. Proc. 2015-13 or successors) to request consent to change its method of accounting. However, in some instances, a statute, regulation or IRS publication may establish unique procedures, terms and conditions for obtaining consent to change a method of accounting. For example see IRC

174, IRC 263A, IRC 448 , and IRC 460 and the related treasury regulations. Thus, it is important that the examiner determine the authority used to support the change in method of accounting.

4.11.6.6.2  
(02-15-2017)  
**Voluntary Change -  
Non-Automatic and  
Automatic Consent (Rev.  
Proc. 2015-13 or  
Successors)**

- (1) Rev. Proc. 2015-13 contains procedures for obtaining non-automatic and automatic consent to change a method of accounting. In general, these procedures apply to all accounting method changes initiated by a taxpayer, except those accounting method changes made under special procedures established by statutes, regulations or IRS publications.
- (2) Rev. Proc. 2015-13 is effective for Forms 3115 filed on or after January 16, 2015 for a year of change ending on or after May 31, 2014. Transition rules provide additional time to file Forms 3115 for non-automatic and automatic method changes under the prior provisions of Rev. Proc. 97-27 and Rev. Proc. 2011-14, respectively.
  - a. For non-automatic method changes, the transition period is applicable for tax years ending on or after November 30, 2014, and on or before January 31, 2015 until March 2, 2015.
  - b. For automatic method changes, the transition period (modified by Rev. Proc. 2015-33) is applicable for tax years ending on or after May 31, 2014 and beginning before January 1, 2015 until the due date of the taxpayer's timely filed (including extensions) tax return for the requested year of change.
- (3) The IRC 481(a) adjustment period is one taxable year for a net negative adjustment and, in general, is four taxable years for a net positive adjustment for an accounting method change. If the taxpayer is under examination, the IRC 481(a) adjustment period is two taxable years unless the taxpayer meets one of the exceptions. See Rev. Proc. 2015-13, § 7.03(3)(b).

4.11.6.6.2.1  
(02-15-2017)  
**Non-Automatic Consent  
Procedures**

- (1) The non-automatic consent procedures:
  - a. Requires payment of a user fee.
  - b. Requires a taxpayer to file a Form 3115 with the Commissioner during year of change. For example, a calendar year taxpayer must file the Form 3115 from January 1st through December 31st of the year of change
  - c. Grants audit protection for years prior to the year of change for taxpayers **not** under examination. See Rev. Proc. 2015-13 § 8
  - d. Provides that the taxpayer receive an accounting method change ruling letter (consent agreement) prior to implementing a method change. See Rev. Proc. 2015-13, § 11.03.
  - e. Requires the taxpayer to accept the terms and conditions of the consent agreement prior to implementing the method change
  - f. Requires the taxpayer to attach the consent agreement to the tax return

4.11.6.6.2.2  
(02-09-2021)  
**Automatic Consent  
Procedures**

- (1) Rev. Proc. 2019-43 (or successors) contains the list of automatic changes in accounting method to which the automatic procedure provisions of Rev. Proc. 2015-13 apply. These procedures are the exclusive procedures for obtaining consent to make any of these specific accounting method changes.
- (2) The automatic consent procedures:

- a. Requires the taxpayer to file the original Form 3115 by attaching it to the timely filed (including extensions) original income tax return for the requested year of change.
  - b. Requires the taxpayer to file a copy of the Form 3115 with the IRS, as directed in Rev. Proc. 2015-13 or successors, no earlier than the first day of the year of change, and no later than the date the original Form 3115 is filed with the timely filed federal income tax return. (For address, see *Rev. Proc. 2019-1*, § 9.05, or successors.) For example, a calendar year taxpayer who files its calendar year 2019 return (with proper extensions) on September 1, 2020 may file a copy of the Form 3115 with the IRS, as directed in Rev. Proc. 2015-13 or successors, for a 2019 year of change, from January 1, 2019 through September 1, 2020 to obtain consent to the change.
  - c. Under certain circumstances, grants an automatic six-month extension to file a Form 3115 from the due date of the return (excluding extensions). See Rev. Proc. 2015-13, § 6.03(4)(a) & (b).
  - d. Permits qualifying taxpayers to file a short Form 3115, for specific method changes. See Rev. Proc. 2015-13, § 3.07(2).
  - e. Requires or allows a qualifying taxpayer to file a statement in lieu of a Form 3115 as an application for consent to make such a change. For example, see Rev. Proc. 2019-43, § 16.10.
  - f. Grants “deemed” consent for the requested method change if the taxpayer fully complies with the provisions of the revenue procedure. See Rev. Proc. 2015-13, § 9.
  - g. Grants audit protection for years prior to the year of change for taxpayers **not** under examination. See Rev. Proc. 2015-13, § 8.
- (3) In determining whether a taxpayer properly made an automatic method change, the examiner should first determine the applicable automatic change revenue procedure (See IRM 4.11.6.1.2) and verify that the specific method change is included as an automatic change. If not included, the examiner should then check to see if any subsequent pronouncement that modified the list of automatic changes addressed the change. Finally, the examiner should verify the taxpayer properly followed the terms and conditions for the specific change in the applicable procedure, as well as, any IRC 481(a) computation.

4.11.6.6.3  
(02-15-2017)  
**Audit Protection  
Resulting from a  
Voluntary Method  
Change**

- (1) A taxpayer who timely files for an accounting method change generally receives **audit protection**, which means that 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. For example, a taxpayer has been using an impermissible method of accounting for advance payments for several years. In 2015, the taxpayer files an application under Rev. Proc. 2015-13 to change to a proper method of accounting for such payments. If the change has audit protection, the Service would not be able to propose an adjustment for the impermissible method of accounting for the advance payments in an examination of an earlier year. See Rev. Proc. 2015-13, § 8.01.
- (2) There is no audit protection for years prior to the requested year of change in the following circumstances:
  - a. Form 3115 filed while under examination  
See IRM 4.11.6.6.3.1.
  - b. Change request lacking audit protection  
See IRM 4.11.6.6.3.2.

- c. Change not made or made improperly  
See IRM 4.11.6.6.3.3.
- d. Change in a sub-method of accounting  
See IRM 4.11.6.6.3.4(1).
- e. CFC or 10/50 corporation  
See IRM 4.11.6.6.3.4(2).
- f. Criminal investigation  
See IRM 4.11.6.6.3.4(3)
- g. Issue under consideration.  
See IRM 4.11.6.6.3.4(4)
- h. Prior year initiated change.  
See IRM 4.11.6.6.3.4(5)

4.11.6.6.3.1  
(02-15-2017)  
**Form 3115 Filed While  
Under Examination**

- (1) Taxpayers who file a Form 3115 while under examination do not receive audit protection unless one of the following six exceptions applies:
- a. **Three-month window** – A taxpayer will have audit protection if it files a Form 3115 during the three-month window that begins on the 15th day of the seventh month and ends on the 15th day of the 10th month of the taxpayer’s tax year; **and** it has been under examination for at least twelve consecutive months as of the first day of the three-month window; **and** the item the taxpayer is requesting to change is not an issue under consideration. See IRM 4.11.6.6.5.  
  
**Note:** The three-month window is intended to include the two-month period immediately before, and the one-month period immediately after, the extended due date for filing a corporate tax return. For example, the three-month window for a calendar year corporate taxpayer is from July 15 through October 15. The extended filing date is September 15th.
  - b. **120-day window** – A taxpayer will receive audit protection if it requests a method change for an item during the 120-day period beginning the day after an examination ends as long as the issue is not an issue under consideration. See IRM 4.11.6.6.5.
  - c. **Present method not before the director** – Audit protection will attach to a change that is from a clearly permissible method of accounting. A method not before the director also includes an impermissible method adopted subsequent to the year(s) under examination.
  - d. **New member of a consolidated group in Compliance Assurance Process (CAP)** – Audit protection attaches to any new member of a consolidated group whose parent’s participation in CAP is the only reason the new member is under examination, and the issue is not an issue under consideration. See IRM 4.11.6.6.5.
  - e. **Change resulting in a negative IRC 481(a) adjustment** – A taxpayer will have audit protection if the method change results in a negative IRC 481(a) adjustment for the year of change and would have resulted in a negative IRC 481(a) adjustment for each year under examination.
  - f. **No examination-imposed change and item not under consideration** – If a taxpayer under examination files a Form 3115 and the Service does not adjust the item that is the subject of the Form 3115 or place the item under consideration when the examination ends, audit protection applies beginning the day after the examination ends. In other words, the taxpayer receives audit protection if the Service does not adjust or suspend the issue. Special rules apply to Forms 3115 filed by a taxpayer

with multiple owners (e.g., CFCs and 10/50 corporations) to allow adequate time for each examination team involved to decide whether to pursue an issue before audit protection attaches.

4.11.6.6.3.2

(02-09-2021)

**Change Request  
Lacking Audit Protection**

- (1) The Service has identified specific method changes in Rev. Proc. 2019-43 (or successors) or other published guidance that do not have audit protection. For example, Rev. Proc. 2019-43, § 7.01 contains the procedures for a change from expensing IRC 174 costs to capitalizing under IRC 263(a). This change is designated change number 17, and the terms and provisions of the change specifically note that the taxpayer does not receive audit protection in connection with this change.

4.11.6.6.3.3

(02-15-2017)

**Change Not Made or  
Made Improperly**

- (1) The Service may change a taxpayer's method of accounting for a prior year if:
  - a. The taxpayer withdraws or does not perfect its method change request.
  - b. The National Office of Chief Counsel denies the taxpayer's request for consent to make a change in accounting method.
  - c. The taxpayer does not timely implement the method change consistent with all applicable provisions.
  - d. The taxpayer timely implements the method change but does not otherwise comply with all the applicable provisions.
  - e. The Commissioner's consent for the change in method is retroactively revoked due to taxpayer misstatement or omission of material facts.

4.11.6.6.3.4

(02-15-2017)

**Other Circumstances  
Where Audit Protection  
Does Not Apply**

- (1) **A change in a sub-method of accounting** – If a taxpayer is changing a “sub-method” within a method, the Service may change a different sub-method or change the method itself for a prior year. For example, an examiner may propose to terminate the taxpayer's use of the LIFO inventory method in a prior year even though the taxpayer changes its method of valuing increments in the current year.
- (2) **CFC or 10/50 corporation** – For a method change made on behalf of a CFC or 10/50 corporation, the Service may change the method for the same item in a prior year if the corporate shareholder's foreign taxes deemed paid exceed 150 percent of the average amount of the foreign taxes deemed paid in the three prior taxable years.
- (3) **Criminal investigation** – If there is any pending or future criminal investigation concerning directly or indirectly any issue related to the taxpayer's federal tax liability or the possibility of false or fraudulent statements made by the taxpayer with respect to any issue, the Service may change the method for the same item that is the subject of a Form 3115.
- (4) **Issue Under Consideration** – The Service may change a taxpayer's method of accounting for the same item that is the subject of a Form 3115 if the item is an issue under consideration. See IRM 4.11.6.6.5.
- (5) **Prior year initiated change** – The Service may make adjustments to a taxpayer's returns for the same item prior to the requested year of change to reflect a change in method of accounting imposed by the IRS for a prior taxable year pursuant to Rev. Proc. 2002-18 (or successors).

4.11.6.6.4  
(02-09-2021)

**Terms and Conditions of  
Voluntary Method  
Change**

- (1) A taxpayer must implement any change in method of accounting requested under Rev. Proc. 2015-13 (or successors) pursuant to the terms and conditions of the revenue procedure in addition to either:
  - a. The automatic change provisions of Rev. Proc. 2019-43 (or successors) for the specific method change, or
  - b. A Consent Agreement issued by National Office of Chief Counsel (non-automatic change).
- (2) IRC 481(a) adjustment period - The applicable number of taxable years that the taxpayer takes the 481(a) adjustment into account. See IRM 4.11.6.6.4.1.
- (3) Changes within the LIFO method of accounting - In general, a taxpayer must implement a change within the LIFO inventory method of accounting on a cut-off basis. A change from one LIFO inventory method or sub method to another LIFO inventory method or sub method is a change within the LIFO inventory method of accounting.
- (4) NOL carryback limitation for taxpayer subject to criminal investigation - A taxpayer subject to criminal investigation may not carry any portion of any net operating loss attributable to a negative IRC 481(a) adjustment back to a taxable year prior to the year of change that is the subject of any pending or future criminal investigation. See Rev. Proc. 2015-13, § 7.05.
- (5) Maintenance of adequate records - The taxpayer must maintain accounting records for the year of change and subsequent taxable years to support the method of accounting for which it received consent.
- (6) Additional terms and conditions apply in the following circumstances:
  - a. A change in method of accounting made on behalf of a CFC or a 10/50 corporation. See Rev. Proc. 2015-13, § 7.07.
  - b. A change in method of accounting of a domestic corporation, domestic partnership, or U.S. person that affects the amount of foreign source taxable income. See Rev. Proc. 2015-13, § 7.08.
  - c. A foreign partnership makes a change in method of accounting. See Rev. Proc. 2015-13, § 7.09.

4.11.6.6.4.1  
(02-15-2017)

**IRC 481(a) Adjustment  
Period**

- (1) **In general** – Unless specifically noted otherwise, the IRC 481(a) adjustment period is one taxable year (year of change) for a negative IRC 481(a) adjustment and four taxable years (year of change and next three taxable years) for a positive IRC 481(a) adjustment.
- (2) **Short period as a separate taxable year** – The taxpayer must treat any short taxable year as if the short taxable year were a full 12-month taxable year during the IRC 481(a) adjustment period.
- (3) **Shortened adjustment periods** – The four-year IRC 481(a) adjustment period for a positive IRC 481(a) adjustment is not applicable in the following situations:
  - a. Cooperatives – In general, one taxable year (year of change) applies to cooperatives.
  - b. Taxpayers under examination – In general, two taxable years (year of change and next taxable year) unless the requested change was filed in a three-month window, a 120-day window, the present method was not

- before the director, or if the taxpayer is a new member of a consolidated group in the Compliance Assurance Process (CAP). See Rev. Proc. 2015-13, § 7.03(3)(b).
- c. De minimis election – If the positive IRC 481(a) adjustment is less than \$50,000, a taxpayer may elect a one-year adjustment period (year of change).
  - d. Eligible acquisition transaction election - See Rev. Proc. 2015-13, § 7.03(3)(d).
- (4) **Accelerated adjustment periods** – An accelerated IRC 481(a) adjustment period for a positive IRC 481(a) adjustment applies in the following situations:
- a. Taxpayer ceases to engage in the trade or business – A taxpayer takes any remaining balance into account in the taxable year of cessation.
  - b. S election effective for the year of LIFO discontinuance – See Rev. Proc. 2015-13, § 7.03(4)(b).
  - c. S election effective for a year after LIFO discontinuance – See Rev. Proc. 2015-13, § 7.03(4)(c).
  - d. Certain transfers pursuant to an IRC 351 transaction within a consolidated group – See Rev. Proc. 2015-13, § 7.03(4)(d).

4.11.6.6.5  
(02-09-2021)  
**Issue Under  
Consideration**

- (1) **Issue under consideration** is a relevant concept when a taxpayer, who is under examination, wishes to file for a voluntary method change under one of the following three exceptions found in Rev. Proc. 2015-13, § 8.02: three-month window, 120-day window, or new member of a consolidated group in the Compliance Assurance Process (CAP).
- (2) In general, a taxpayer under examination who files for a method change is subject to limited terms and conditions and does not receive audit protection unless an exception applies. See IRM 4.11.6.6.3 and IRM 4.11.6.6.4. A taxpayer may not file under any of the three exceptions, above, if the item that is the subject of the method change request, is an issue under consideration.
- (3) A taxpayer's method of accounting for an item is an issue under consideration for the taxable years under examination if the examining agent(s) provides the taxpayer with written notification (for example, by examination plan, information document request (IDR), notification of proposed adjustment (NOPA) or income tax examination changes) specifically citing the treatment of the item as an issue under consideration. See Rev. Proc. 2015-13, § 3.08 for examples of an issue under consideration.
- (4) If the Service does not propose an adjustment for an item that is an issue under consideration, the item continues to be an issue under consideration only if the issue is placed in suspense.
- (5) An issue placed in suspense is included within the definition of an issue under consideration. An issue is placed in suspense, if by the date the examination ends, the Service provides the taxpayer with written notification that the IRS intends to examine the issue during the examination of the subsequent taxable year(s).
- (6) Examiners may refer questions of whether a method of accounting is an issue under consideration to the National Office of Chief Counsel as a request for technical advice under the provisions of Rev. Proc. 2021-2 (or successors).

4.11.6.6.6  
(02-09-2021)  
**Compliance  
Responsibilities  
Regarding Voluntary  
Method Changes**

- (1) **Responsibilities for changes filed for a subsequent year** - If a taxpayer under examination files a Form 3115, it must provide a copy of the Form 3115 to the examiner no later than the date the taxpayer timely files the Form 3115 (original or duplicate copy, whichever is earlier, in the case of an automatic change).
- (2) When an examiner receives a copy of a Form 3115 from a taxpayer, the examiner should determine whether the taxpayer has audit protection for prior years. See IRM 4.11.6.6.3.
  - a. If the taxpayer has audit protection, the examiner cannot require the taxpayer to change its method of accounting for the same item for taxable years prior to the year of change.
  - b. If the taxpayer does not have audit protection, the examiner should consider changing the taxpayer's method of accounting in the earliest year under examination.
- (3) After the review of the Form 3115, the examiner may have questions or concerns with the request (e.g., Automatic change v. Non-Automatic change, Changing to an impermissible method).
  - a. The examiner should advise the taxpayer of the concern(s) and document the fact that the taxpayer was so advised.
  - b. The examiner should document the concerns in the historical file, or file an information report, so the concerns are considered upon examination of the method change in the year of change.
  - c. If the request was made pursuant to a non-automatic consent procedure, the examiner may contact the National Office of Chief Counsel attorney assigned to the request to discuss the concerns. Contact the Methods of Accounting and Timing Practice Network to coordinate with the assigned National Office of Chief Counsel attorney.
- (4) **Responsibilities for changes filed for a year under examination** – An examiner should consider the following as potential areas of inquiry when examining a tax return in which a taxpayer has implemented a voluntary change in accounting method.
- (5) **Non-automatic method change:**
  - Was the ruling letter granting consent to the change followed?
  - Is the method the taxpayer implemented consistent with the facts presented and the representations made in the consent agreement?
  - Is the IRC 481(a) adjustment correct?

**Note:** Exam may correct the IRC 481(a) adjustment without a Technical Advice Memorandum (TAM).

**Note:** Exam may take into account the entire amount necessary to correct an IRC 481(a) adjustment in the earliest year of the IRC 481(a) adjustment period under examination. See Rev. Proc. 2015-13 , § 12.02(2).

  - Exam may perfect the method change as an examination adjustment when deemed appropriate.
  - A TAM is required to revoke or modify the ruling letter.
- (6) **Automatic method change:**

- Did the taxpayer fully comply with the provisions in the voluntary method change procedure (Rev. Proc. 2015-13 or successors)?
- Is the method the taxpayer implemented consistent with the automatic method change provisions described in Rev. Proc. 2019-43 (or successors) for the designated change number?  
**Note:** If the method change is invalid, exam may raise an unauthorized method change issue.
- Is the IRC 481(a) adjustment correct?  
**Note:** Exam may correct the IRC 481(a) adjustment without a TAM.  
**Note:** Exam may take into account the entire amount necessary to correct an IRC 481(a) adjustment in the earliest year of the IRC 481(a) adjustment period under examination. See Rev. Proc. 2015-13, § 12.02(2).
- Exam may perfect the method change as an examination adjustment when deemed appropriate.
- A TAM is necessary if the taxpayer made the method change in compliance with the applicable procedures but the examiner wants to revoke or modify the method change.

- (7) If Exam determines the taxpayer's change in method of accounting does not comply with all applicable provisions, Rev. Proc. 2015-13, § 12.02 provides that the examiner may:
- a. Make any adjustments (including the amount of any IRC 481(a) adjustment) to bring the change in method of accounting into compliance with all the applicable provisions,
  - b. Deny the change in method of accounting and place the taxpayer on a proper method of accounting, or
  - c. Deny the change in method of accounting and require the taxpayer to continue to use the prior method of accounting.

4.11.6.7  
(02-15-2017)  
**Procedures for  
Implementing  
Involuntary  
(Service-imposed)  
Change**

- (1) Rev. Proc. 2002-18 provides the general procedures for involuntary changes in methods of accounting. This revenue procedure provides terms and conditions for a Service-imposed change in method of accounting and are intended to encourage taxpayers to voluntarily request a change from an impermissible method of accounting prior to being contacted for examination. A taxpayer that is contacted for examination and required to change its method of accounting by the Service ("involuntary change") generally receives less favorable terms and conditions when the change results in a positive IRC 481(a) adjustment than if the taxpayer had filed an application to change its method of accounting ("voluntary change") before it was contacted for examination. For example, an involuntary method change is generally made in an earlier year of change and a one-year IRC 481(a) adjustment period (year of change) for a positive adjustment. A taxpayer makes a voluntary change with a current year of change and a longer IRC 481(a) adjustment period for a positive adjustment.

- 4.11.6.7.1  
(02-09-2021)  
**Effect of Rev. Proc. 2002-18 on Authority of Examination, Appeals and Counsel**
- (1) Revenue Procedure 2002-18 sets forth procedures for Examination, Appeals, and Counsel for the government to resolve accounting method issues. It does not alter Examination's authority to examine the returns of a taxpayer. It provides parameters for Examination to resolve accounting method issues, but does not limit or expand Examination's authority to resolve any issues under any applicable Delegation Order (e.g., Delegation Order 4-24 and Delegation Order 4-25). This revenue procedure also does not alter or limit the authority of Appeals or Counsel for the government to resolve or settle any issues.
- 4.11.6.7.2  
(05-13-2005)  
**Circumstances When a Service-imposed Method Change May Be Encountered**
- (1) Examiners face potential accounting method change issues in three situations:
- The examiner determines that the taxpayer's accounting method does not clearly reflect income or is improper - IRC 446(b) issue.
  - The taxpayer changed its method of accounting without obtaining the consent of the Commissioner - IRC 446(e) issue.
  - The taxpayer filed an amended return or claim (formal or informal) which constitutes a **retroactive** change in accounting method. - IRC 446(e) issue. See Rev. Rul. 90-38 .
- 4.11.6.7.3  
(05-13-2005)  
**IRC 446(b) - Accounting Method Used Does Not Clearly Reflect Income**
- (1) IRC 446(b) and 26 CFR 1.446-1(b)(1) provide that if a taxpayer does not regularly employ a method of accounting that clearly reflects income, the computation of taxable income must be made in the manner that, in the opinion of the Commissioner, does clearly reflect income. The Commissioner has broad discretion in determining whether a taxpayer's method of accounting clearly reflects income, and the Commissioner's determination must be upheld unless it is clearly unlawful. Once the Commissioner has determined that a taxpayer's method of accounting does not clearly reflect income, the Commissioner has broad discretion in selecting a method of accounting, which properly reflects income. The taxpayer may challenge the selection only upon showing an abuse of discretion by the Commissioner. The Commissioner does not have discretion to require a taxpayer to change from a method of accounting that clearly reflects income to a method that, in the Commissioner's view, more clearly reflects income.
- (2) Accordingly, the first determination that the examiner must make is whether the taxpayer's adopted accounting method for an item is permissible. The examiner must first make a concerted effort to understand the taxpayer's accounting method for the item(s) in question. This determination may entail having the taxpayer walk the examiner through transactions, journal entries, or other books and records. Generally, the examiner should verify examples of journal entries shown by the taxpayer based upon hypothetical data with actual transactional data including actual journal entries that are contained in the books and records. After the examiner acquires an understanding of the taxpayer's transactions and accounting method for items, the examiner needs to ascertain permissible accounting treatment(s) based upon the Service's position.
- (3) Generally, there are established Service positions as to what are proper methods of accounting for items. However, if the examiner is unable to ascertain the Service's position or if there is no official Service position and the examiner believes there is an accounting method issue, the examiner may consider seeking advice (formal or informal) from local field counsel, the National Office of Chief Counsel subject matter experts, or the Methods of Accounting and Timing Practice Network.

- (4) If the taxpayer's accounting method for item(s) is impermissible, the examiner may propose an adjustment with respect to that method only by changing the taxpayer's method of accounting pursuant to Rev. Proc. 2002-18, in order to place the taxpayer on a proper method of accounting for such item(s).

4.11.6.7.4  
(02-09-2021)  
**IRC 446(e) - Taxpayer  
Changed Method  
Without Obtaining Prior  
Consent**

- (1) IRC 446(e) provides 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. The Commissioner may require a taxpayer that has changed a method of accounting without the Commissioner's consent to change back to its former method. The Commissioner may do so even when the taxpayer changed from an impermissible to a permissible method. The Service may change the taxpayer back to its former method in the taxable year the taxpayer changed without consent, or if the statute of limitations is closed for that year, in the earliest open year. For example, the Service may change a taxpayer back to its former impermissible method of accounting if the taxpayer changed to a permissible method of accounting without the Commissioner's consent, even where the statute of limitations has expired for the year of change. See Rev. Proc. 2002-18, § 2.06.
- (2) While the examiner may allow an unauthorized method change, such action should only be an exception. The examiner, using professional judgment, should consider the following factors when applying the exception:
  - a. **Benefit to taxpayer/Cost to government** – The examiner should quantify the time-value-of-money benefit the taxpayer will receive by allowing the taxpayer's non-compliance with the consent requirements. Specifically, the examiner should determine the impact (including restricted interest computations) of not moving the year of change from the earliest year under examination to the current year. The supposition that the method change the taxpayer made without consent may have been granted if the taxpayer had complied with the consent requirements should not be a consideration.
  - b. **Jurisdiction of oversight** – The examiner should determine the proper procedure the taxpayer should have followed to implement the change, and what the taxpayer circumvented by making the unauthorized change. For example, if the taxpayer should have followed the non-automatic change provisions under Rev. Proc. 2015-13, the taxpayer would have paid a fee (e.g., \$8,600) and received a ruling letter with terms and conditions specified by National Office of Chief Counsel. In addition, the taxpayer did not put the Service on notice that it made the method change, nor make representations regarding that change, by filing a Form 3115.
  - c. **Utilization of resources** – The examiner should analyze the impact on the examination for expending the time and resources required for the necessary compliance oversight of the unauthorized method change as opposed to other potential areas of examination.
  - d. **Fairness to all** – The examiner should consider the disparity that results if the taxpayer's unauthorized change in method of accounting is allowed while the similarly situated taxpayer not under examination must file a Form 3115 and make the change in a later year. In addition, the examiner should consider any negative impact on compliance that may result from the examiner's action. (Refer to Policy Statement 1-236 in IRM 1.2.1.2.36)

- (3) The examiner should fully explain in the work papers the rationale for proposing or not proposing the unauthorized method change issue. If a change in method of accounting issue is not proposed, the examiner should confirm and document that the taxpayer treated all items in a manner that prevents the duplication or omission of items of income or deduction. If the unauthorized method change duplicates or omits income or deductions, the examiner should make adjustments to correct these items. The examiner should contact the Methods of Accounting and Timing Practice Network for assistance in addressing these arguments if necessary.

4.11.6.7.5  
(02-15-2017)  
**IRC 446(e) - Taxpayer Files Amended Return or Claim (Formal or Informal) to Make “Retroactive” Change in Accounting Method**

- (1) **Error correction or retroactive accounting method change?** Often, during the conduct of an examination, the examining agent will encounter a claim (formal or informal) requesting an adjustment. The examiner should carefully review such claim to determine whether the claim constitutes:
- The correction of an item that does not involve “timing”
  - A request for a retroactive change in method of accounting for a year under examination

4.11.6.7.5.1  
(02-15-2017)  
**Considering a Retroactive Accounting Method Proposed by the Taxpayer**

- (1) **Taxpayer’s existing method of accounting is permissible.** If the claim constitutes a request for a retroactive change in method of accounting, the examiner should determine whether the taxpayer’s existing method of accounting is permissible. If the taxpayer’s existing method of accounting is *permissible*, the examiner should NOT impose the method change requested by the taxpayer in an RAR. Rather, the examiner should advise the taxpayer to request consent to make the method change on a prospective basis in the current year. Stated another way, the examiner should not impose retroactive changes from one permissible method to another; the taxpayer should initiate a “permissible to permissible” change under the voluntary method change procedures (Rev. Proc. 2015-13).
- (2) **Taxpayer’s existing method of accounting is impermissible.** If the taxpayer’s existing method of accounting is impermissible, the examiner should consider the following factors in determining whether to impose a retroactive method change requested by the taxpayer:
- Is the change the product of Service-initiated examination activity?**  
In general, the Service should make a taxpayer-requested method change when the adjustment is fairly considered the product of Service-initiated examination activity. In making this determination, the examiner should consider all relevant facts and circumstances, including whether the examiner has submitted request(s) for extensive information for an item, and whether the taxpayer has substantially and appropriately complied with any such requests.

**Example:** Service-initiated examination activity does not include activities undertaken in response to a taxpayer claim (formal or informal) **or** activities undertaken to review a taxpayer-initiated method change (authorized or unauthorized). As a general matter, the examining agent, in his/her discretion, determines the scope of an examination. Accordingly, the examining agent has wide discretion in choosing what sort of examination activities to initiate.

- b. **Is an item substantially similar to an item for which the Service has initiated examination activity?** To the extent the examiner or taxpayer identifies item(s) which are “substantially similar” to an item for which the Service has initiated examination activity, these item(s) should be included in any proposed method change.

**Note:** An item is “substantially similar” if it is governed by the same subsection of the code and/or regulations **AND** relates to the same type of expenditure, income item or property for which the Service is imposing a change in method of accounting for the taxable period.

Imposing a method change for a “substantially similar” item generally does not require a substantial amount of additional audit resources because the item involves the same legal authority and accounting entries as other items for which the Service has already initiated examination activity under the audit plan. Accordingly, if imposing the method change requested by the taxpayer would divert substantial resources from the focus of the planned examination, the change probably does not involve a “substantially similar” item.

4.11.6.7.5.2

(02-15-2017)

**Declining to Impose a Retroactive Accounting Method Change Proposed by the Taxpayer**

- (1) Generally, it is not appropriate for a taxpayer to obtain more advantageous terms and conditions by requesting a change in accounting method after contact for an examination. In addition, routine consideration of taxpayer requests for retroactive method changes would consume substantial examination resources and thereby impede the Service’s enforcement efforts. The Service’s refusal to make taxpayer-requested retroactive method changes is consistent with equitable tax administration, since the taxpayer chooses the original method of accounting and may change from an impermissible method on a prospective basis by filing a Form 3115.
- (2) If questions exist, the examiner should contact the Methods of Accounting and Timing Practice Network. If the examiner deems it necessary to decline to initiate an accounting method change, the examiner should recommend that the taxpayer request consent to make a voluntary method change pursuant to the appropriate administrative procedure.

4.11.6.7.5.3

(02-15-2017)

**Change in Service’s Position**

- (1) Where the service has changed its position with respect to a particular method of accounting (i.e., it recognizes the permissibility of a method which it previously viewed as impermissible), a taxpayer may request that the examiner allow a change to the previously controverted method in the years under examination via formal or informal claim. The Service recognizes such circumstances as “unique and extraordinary”. To avoid disparate treatment (differing determinations and differing terms of change) between taxpayers under examination and those not under examination, the National Office of Chief Counsel should make such determination rather than the examiner. Examiners may contact the Methods of Accounting and Timing Practice Network, and if warranted, submit a request for technical advice.

4.11.6.7.5.4

(02-15-2017)

**Correction of an Error**

- (1) Where an examiner determines that an error correction is necessary, and it is not a method change issue, the examiner should make such error correction for the years under examination regardless if the adjustment is positive or negative.

4.11.6.7.6  
(02-15-2017)

**Terms of an Involuntary  
Change Imposed By the  
Examiner**

- (1) Using professional judgment in accordance with auditing standards, an examining agent will make findings of fact and apply Service position on issues of law to determine whether an issue is an accounting method issue and whether the taxpayer's method of accounting is permissible. The term "accounting method issue" means an issue addressing whether the taxpayer's accounting treatment of an item is proper, but only if changing the taxpayer's treatment of such item could constitute a change in method of accounting. See 26 CFR 1.446-1(e)(2) and Rev. Proc. 2002-18, § 2.01 and § 3.01.
- (2) An examining agent who determines that a taxpayer's method of accounting is impermissible or that a taxpayer changed its method of accounting without obtaining the consent of the Commissioner may propose an adjustment with respect to that method **only** by changing the taxpayer's method of accounting. Failure to recognize and properly treat an accounting method issue as a change in method of accounting can result in a permanent overstatement or understatement of a taxpayer's lifetime taxable income. See Rev. Proc. 2002-18, § 5.02
- (3) An examining agent changing a taxpayer's method of accounting will select a new method of accounting by properly applying the law to the facts determined by the agent. The method selected must be a proper method of accounting and will not be a method contrived to reflect the hazards of litigation. See Rev. Proc. 2002-18, § 5.03
- (4) An examining agent changing a taxpayer's method of accounting will make the change in a year under examination. Ordinarily, the examiner will make the change in the earliest taxable year under examination, or, if later, the first taxable year the Service considers the method impermissible. However, in appropriate circumstances, an examining agent may defer the year of change to a later taxable year. See Rev. Proc. 2002-18 § 5.04(1). Deferring the year of change to reflect the hazards of litigation to a year later than the earliest year under examination is not appropriate.
- (5) An examining agent changing a taxpayer's method of accounting ordinarily will impose an IRC 481(a) adjustment, subject to a computation of tax under IRC 481(b) (if applicable). See Exhibit 4.11.6-1 and Exhibit 4.11.6-2. However, an examining agent should use a cut-off method to make a change (other than a change within the LIFO inventory method as defined in Rev. Proc. 2015-13 § 7.04, or a change in method of accounting for intercompany transactions (See 26 CFR 1.1502-13 )) when a statute, regulation or administrative pronouncement of the Service effective for the year of change directs that the change be made using a cut-off method. See, e.g., IRC 174. In addition, an examining agent may use a cut-off method to make a change in appropriate circumstances. See Rev. Proc. 2002-18 § 5.04(2). It is not appropriate for exam to impose a change in accounting method using a cut-off method to reflect the hazards of litigation.
- (6) The IRC 481(a) adjustment, whether positive or negative, will be taken into account entirely in the year of change. See Rev. Proc. 2002-18, § 5.04(3).

4.11.6.7.7  
(02-15-2017)

**Finalization of a  
Service-imposed Method  
Change**

- (1) An examining agent changing a taxpayer's method of accounting will provide written notice that the Service is treating an accounting method issue as an accounting method change. Resolution of an accounting method issue without notice will not establish a new method of accounting. Written notice is a statement in the RAR that the Service is proposing a method change pursuant

to IRC 446 and IRC 481. To implement a Service-imposed change in accounting method, Rev. Proc. 2002-18 provides that the taxpayer and the Service should execute a closing agreement under IRC 7121 in which the taxpayer agrees to the change and the terms and conditions of the change. A model closing agreement is included in the revenue procedure. A closing agreement is not mandatory and in actual practice, it is the exception and not the norm.

- (2) The written notice must include:
  - a. A statement that the accounting method issue is being treated as an accounting method change or a clearly labeled IRC 481(a) adjustment
  - b. A description of the new method of accounting
- (3) If the taxpayer and the Service execute a closing agreement, the change is final as of the date of the agreement (unless otherwise provided by a federal court). In the absence of such an agreement, a Service-imposed accounting method change is final only upon the expiration of the period of limitations for filing a claim for refund under IRC 6511 for the year of change or the date of a final court order requiring the change.
- (4) The Service should make the adjustments necessary to effect a Service-imposed accounting method change to the taxpayer's returns for the taxable years under examination, before Appeals, or before a federal court. These adjustments include the adjustments to taxable income necessary to reflect the new method (including the required IRC 481(a) adjustment), and any collateral adjustments to taxable income or tax liability resulting from the change.
- (5) If the taxpayer does not use the new method on any return filed prior to the date a Service-imposed change becomes final, and does not file amended returns to reflect the change, the Service should make the adjustments necessary to reflect the change for the affected taxable years if and when it examines those returns.

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**Exhibit 4.11.6-1 (02-15-2017)**  
**IRC 481(a) Adjustment Calculation**

A change in method of accounting requires restatement of the tax accounts of the taxpayer on the first day of the year of change as if the taxpayer had always used the new method of accounting. The taxpayer uses the new method of accounting to determine income from that day forward. The tax accounts at the close of the preceding tax year and taxable income for that tax year remain as determined under the **old** method of accounting.

As a result of the mismatch between the old and new methods, some items may be treated in inconsistent ways under the old and new accounting methods, which could distort the lifetime income of the taxpayer. For example, a taxpayer switching from cash to accrual would establish an accounts payable on the first day of the year of change for its expenses incurred on credit. An omitted deduction would occur, because the expenses were not deductible under the cash method as incurred and will not be deductible under the accrual method when they are paid.

To address this problem IRC 481 requires that the taxpayer take into account any adjustments required to offset duplications or omissions of income or expense that result from a change in method of accounting.

Distortion	Offsetting Adjustment
Omitted deduction	Negative IRC 481(a) adjustment
Omitted income	Positive IRC 481(a) adjustment
Duplicated deduction	Positive IRC 481(a) adjustment
Duplicated income	Negative IRC 481(a) adjustment
	Net IRC 481(a) adjustment

The following cases address various issues associated with IRC 481(a) adjustments:

- *Bosamia v. Commissioner*, 661 F.3d 250, 254 (5th Cir. 2011)
- *Huffman v. Commissioner*, 518 F.3d 357,362 (6th Cir. 2008)
- *Suzy's Zoo v. Commissioner*, 114 T.C. 1, 12-13 (2000), aff'd 273 F.3d 875, 883 (9th Cir. 2001)
- *Rankin v. Commissioner*, 138 F.3d 1286, 1288 (9th Cir. 1998)
- *National Life Ins. Co. v. Commissioner*, 103 F.3d 5, 7 (2d Cir. 1996)
- *Primo Pants Co. v. Commissioner*, 78 T.C. 705, 723 (1982)
- *Graff Chevrolet Company v. Commissioner*, 343 F.2d 568, 572 (5th Cir. 1965)

The following illustrates the computation of the IRC 481(a) adjustment due to a change in accounting from deducting sales allowances when added to a reserve to deducting such items when they meet the all events test and economic performance under IRC 461. The adjustment is the duplicated expense caused by the difference in balance sheet account amounts per return (old accounting method) and as corrected (new accounting method) on the first day of the year of change.

**Example of the required calculation under IRC 481(a)**

Assume that 2012 is the earliest year under examination. The 2012 year is the year of change

Account	01/01/2012	12/31/2012
G/L Sales Allowance Reserve	\$6,000,000	\$6,500,000

**Exhibit 4.11.6-1 (Cont. 1) (02-15-2017)**  
**IRC 481(a) Adjustment Calculation**

**FACTS**

- Taxpayer’s accounting practice has been to deduct amounts when it makes additions to the reserve (i.e. credits the reserve).
- In prior years (statute closed), the taxpayer accrued and deducted \$6,000,000; in 2012 the taxpayer added \$500,000 to this reserve.
- The additions to the reserve are not included as an increase to taxable income on Schedule M-3.

**LAW**

- Under IRC 461, the additions to the reserve are not deductible in the year when they are recorded.
- The sales allowances are not deductible until all 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.
- A “timing issue” is involved because the issue is **when** an item is deductible, not **whether** an item is deductible.
- A *Change in Accounting Method* is necessary to deduct the amounts when they meet the requirements of IRC 461, *not* when the taxpayer adds amounts to the reserve.

**SOLUTION**

- The Service initiates a change in accounting method during the examination.
- The **new** method of accounting begins as of 01/01/2012 – the earliest period under examination.
- Beginning on 01/01/2012, the taxpayer deducts sales allowances when such items meet the **all events** test and economic performance under IRC 461.
- Sales allowance deductions under the new method of accounting beginning on 01/01/2012 that were added to the reserve and deducted prior to 01/01/2012 will result in a duplicated deduction.
- An adjustment is required pursuant to IRC 481(a) to prevent the duplicated deduction.

The 481(a) adjustment is \$6,000,000, which is the reserve account balance (i.e., balance sheet account) at the beginning of the year of change. The current year adjustment is \$500,000, which is the difference between the balances at the beginning and the end of the year. The RAR separately states and clearly identifies the two adjustments.

IRC 481(a) adjustment	\$6,000,000
Current year adjustment (sales allowances)	\$500,000
Total Adjustment	\$6,500,000

The RAR should address the substantive issue (IRC 461) and indicate that this is a change in accounting method pursuant to IRC 446 and IRC 481(a). See Rev. Proc. 2002-18, § 7.01.

**Exhibit 4.11.6-2 (02-15-2017)****IRC 481(b) Tax Limitation Computation**

Under IRC 481(b)(1), if the IRC 481(a) adjustment increases the taxpayer's taxable income for the year of the change by more than \$ 3,000, then the tax for such year that is attributable to the adjustment shall not exceed the lesser of:

1. The tax attributable to the IRC 481(a) adjustment by including it in taxable income for the taxable year of change under IRC 481(a) and Treas. Reg. 1.481-1, or
2. The aggregate of the increases in tax that would result if the adjustment were included ratably in the taxable year of the change and the two preceding taxable years.

**Note:** While IRC 481(b) may limit the tax, it does not change the year in which the tax is due. **This computation is mandatory for examiners changing a taxpayer's method of accounting.**

IRC 481(b)(2) provides a second alternative limitation on the tax for the taxable year of change. If the taxpayer establishes from its books and records what its taxable income would have been under the new method of accounting for one or more consecutive taxable years immediately preceding the taxable year of the change, then the tax attributable to the IRC 481(a) adjustments shall not exceed the smallest of the following amounts:

1. The tax attributable to the IRC 481(a) adjustment by including it in taxable income for the taxable year of the change;
2. The tax attributable to such adjustments computed under the 3-year allocation provided in IRC 481(b)(1), if applicable; or
3. The tax attributable to a specific allocation of the IRC 481(a) amount to the preceding source years as provided in IRC 481(b)(2), if applicable.

Steps for computing the tax:

1. Compute the increase in tax for the year of the change that is attributable to the adjustments required under IRC 481(a). Calculate this increase by taking the difference in tax that would be due in the year of change with the IRC 481(a) adjustment and the tax computed for such year without the IRC 481(a) adjustment.
2. Compute the tax attributable to the IRC 481(a) adjustments pursuant to IRC 481(b)(1) for the taxable year of the change and the two preceding taxable years as if an amount equal to one-third of the net amount of such adjustments had been received or accrued in each of such taxable years. Calculate this increase by taking the excess of the tax for such year computed *with* the allocation of one-third of the net adjustments to such taxable year and subtracting the tax computed *without* the allocation of any part of the adjustments to such year.
3. If taxpayer satisfies the conditions set forth in IRC 481(b)(2), compute the tax attributable to the IRC 481(a) adjustment for the taxable year of the change and the consecutive taxable year or years immediately preceding the taxable year of the change for which the taxpayer can establish its taxable income under the new method of accounting. Calculate this increase by taking the excess of the tax for such year computed with the allocation of the net adjustments to such taxable year over the tax computed without the allocation of any part of the adjustments to such year.

Example of IRC 481(b)(1) Tax Calculation using a \$6,000,000 IRC 481(a) adjustment, a \$500,000 current year adjustment and corporate tax rates:

Step 1: Determine tax attributable to the entire IRC 481(a) adjustment in the year of change.

- a. Tax with all adjustments *including* IRC 481(a) adjustment
- b. Tax with all adjustments *excluding* IRC 481(a) adjustment
- c. Difference is tax attributable to IRC 481(a) adjustment

Step 2. Determine tax under **hypothetical** 3-year spreadback of IRC 481(a) adjustment.

**Exhibit 4.11.6-2 (Cont. 1) (02-15-2017)**  
**IRC 481(b) Tax Limitation Computation**

- a. Divide IRC 481(a) adjustment by 3.
- b. Plug 1/3 of the IRC 481(a) adjustment into the year of change and the two immediately preceding tax years.

**Note:** The year of change will include all adjustments plus 1/3 of the IRC 481(a) adjustment.

- c. Determine increase in tax attributable to 1/3 of the IRC 481(a) adjustment plugged into each year. (If NOL, follow change in NOL to carryback year(s).)

	2010	2011	2012
Taxable Income (see below)	\$6,000,000*	\$8,000,000*	\$11,000,000**
1/3 of IRC 481(a) adjustment	\$2,000,000	\$2,000,000	\$2,000,000
Taxable Income - IRC 481(b)(1)	\$8,000,000	\$10,000,000	\$13,000,000
Tax - IRC 481(b)(1)	\$2,720,000	\$3,400,000	\$4,450,000
Tax	\$2,040,000*	\$2,720,000*	\$3,750,000*
Hypothetical Tax Increase per IRC 481(b)(1)	<b>\$680,000</b>	<b>\$680,000</b>	<b>\$700,000</b>
Sum Total Increase in Tax			<b>\$2,060,000</b>

\* Per tax return or as adjusted

\*\* Per exam without IRC 481(a) adjustment

Step 3: Determine if the tax is limited under IRC 481(b)(1).

- a. Add total increases determined under Step 2.
- b. Subtract total increase determined under Step 1.
- c. If negative, treat difference as a "tax credit" in year of change.
- d. If positive, IRC 481(b)(1) does not apply.
- e. RAR will always reflect the entire IRC 481(a) adjustment.

Total <b>hypothetical</b> tax increase per IRC 481(b)(1) from Step 2	\$2,060,000
Less: Tax increase attributable to IRC 481(a) under the regular tax computation from Step 1	\$2,160,000
If negative, to be reflected as a tax credit in RAR for the tax year of change.	(\$100,000)

Exhibit 4.11.6-3 (02-09-2021)

Differences Between Non-Automatic and Automatic Voluntary Method Change Procedures - Rev. Proc. 2015-13

Non-Automatic consent	Automatic consent
Applies to all changes other than changes subject to the automatic consent procedures.	Applies only to certain changes designated for automatic consent. Rev. Proc. 2019-43 (or successors) consolidates these changes and includes changes allowed pursuant to subsequent pronouncements. (For new automatic changes that are not included in Rev. Proc. 2019-43, see the Methods of Accounting and Timing Practice Network website.)  A taxpayer using the automatic procedures for a change that is not eligible for automatic consent <i>does not</i> receive consent under IRC 446(e). The taxpayer must amend its returns to go back to the old method and then seek consent under the non-automatic consent procedures.
Taxpayer receives a ruling letter.	Taxpayer does not receive a ruling letter.
National Office of Chief Counsel reviews change request before issuing the ruling letter.	No review is conducted before consent is <b>deemed</b> to be granted. "Post-consent" review may be conducted by the National Office of Chief Counsel (if the Form 3115 is selected) or by examiners (if taxpayer is audited).
Taxpayer must wait to receive its ruling letter, which becomes the consent agreement once signed by the taxpayer, before implementing the change on a filed return. A copy of the consent agreement is required to be attached to the tax return.	Taxpayer gets automatic consent and may file using the new method without waiting. Consent is only valid, however, to the extent that the taxpayer complies with the terms and conditions of Rev. Proc. 2015-13 and the automatic change provisions of Rev. Proc. 2019-43 (or successors) for the specific method change.
<i>One</i> Form 3115 filed with National Office of Chief Counsel.	<i>Two</i> Forms 3115 required: a <b>copy</b> of Form 3115 is filed with the IRS, at the applicable address in § 9.05 of Rev. Proc. 2019-1 (or successors), and <b>original</b> is attached to a timely filed return for the year of change.
Taxpayer must file <i>during</i> the year of change	Taxpayer may file from the first day of the year of change through the <i>extended due date of the return</i> to complete its filing.
Taxpayer filing is acknowledged.	Taxpayer gets no acknowledgement of filing.
User fee is charged	No user fee is required

**Exhibit 4.11.6-4 (02-15-2017)****Summary of Citations for Key Terms and Concepts in Rev. Proc. 2015-13**

<b>Terms and Concepts</b>	<b>Rev. Proc. 2015-13 Ref: Section</b>	
Method of accounting	2.01	
Change in method of accounting defined	2.02	
No retroactive method change	2.05	
Method change IRC 481(a) adjustment	2.06	
Method change cut-off	2.07	
Applicable provisions defined	3.01	
Under Examination	3.18	
Examination begins	3.18(1)(a)	
Examination ends	3.18(1)(a)(i)-(iii)	
Issue under consideration	3.08	
IRC 481(a) adjustment period	7.03	
Audit Protection	8	
Three-month Window	8.02(1)(a)	
120-day window	8.02(1)(b)	
Present method not before the Director	8.02(1)(c)	
Changes lacking audit protection	8.02(2)	
Review by the Director	12	
Compliance with revenue procedure	12.02	