

Part III

Administrative, Procedural, and Miscellaneous

26 CFR 601.204: Changes in accounting periods and methods of accounting.
(Also Part I, §§ 162, 263(a), 446, 481; 1.162-3, 1.263(a)-1, 1.446-1, 1.481-1.)

Rev. Proc. 2002-12

SECTION 1. PURPOSE

This revenue procedure provides taxpayers engaged in the trade or business of operating a restaurant or tavern (as defined in section 4.01 of this revenue procedure) with a safe harbor method of accounting for the cost of “smallwares” (as defined in section 4.02 of this revenue procedure) (“smallwares method”). This revenue procedure also provides a procedure for such taxpayers to obtain automatic consent of the Commissioner to change to the smallwares method.

SECTION 2. BACKGROUND

.01 The trade or business of operating a restaurant or tavern requires the use of many items in the preparation, service, and storage of food and beverages. Pots and pans, dishes, and glassware are common examples of these items, known as “smallwares” in the restaurant industry. Generally, an “opening package” of smallwares is purchased before a restaurant or tavern opens its doors to customers. Although an

opening package is made up of hundreds or thousands of items, it is typically purchased as one unit from the same vendor. Replacement items are thereafter purchased on an ongoing basis. Industry data shows that the average cost of an opening package of smallwares ranges from \$10,000 to \$50,000, and that smallwares have an average useful life of slightly over one year.

.02 Section 162(a) of the Internal Revenue Code allows a deduction for ordinary and necessary expenses paid or incurred during the taxable year in carrying on a trade or business. Under § 1.162-3 of the Income Tax Regulations, the cost of materials and supplies (other than incidental materials and supplies) may be deducted only to the extent that the materials and supplies are actually consumed and used in the taxpayer's business during the taxable year.

.03 Section 263(a) provides that no deduction is allowed for the cost of new buildings or of permanent improvements or betterments made to increase the value of any property or estate. Section 1.263(a)-2(a) provides examples of capital expenditures, such as the cost of acquisition, construction, or erection of buildings, machinery and equipment, furniture and fixtures, and similar property having a useful life substantially beyond the taxable year.

.04 Except as otherwise provided, under §§ 446(e) and 1.446-1(e), a taxpayer must secure the consent of the Commissioner before changing a method of accounting for federal income tax purposes. Section 1.446-1(e)(ii) authorizes the Commissioner to prescribe administrative procedures setting forth the limitations, terms, and conditions deemed necessary to permit a taxpayer to obtain consent to change a method of accounting. Section 481(a) generally requires those adjustments necessary to prevent

amounts from being duplicated or omitted to be taken into account when a taxpayer's taxable income is computed under a method of accounting different from the method used to compute taxable income for the preceding taxable year.

.05 To resolve disputes concerning whether the cost of smallwares should be accounted for as currently deductible expenses under § 162 or capital expenditures within the meaning of § 263(a), and to simplify the record keeping requirements with respect to smallwares, the Internal Revenue Service will permit a taxpayer engaged in the trade or business of operating a restaurant or tavern that complies with the requirements of this revenue procedure to account for the cost of smallwares using the smallwares method provided in section 5 of this revenue procedure.

SECTION 3. SCOPE

This revenue procedure applies to the cost of smallwares incurred by taxpayers engaged in the trade or business of operating a restaurant or tavern. It does not apply to the cost of smallwares that are start-up expenditures as defined in § 195. Thus, a taxpayer that is not already engaged in the trade or business of operating a restaurant that opens a new restaurant may not use the smallwares method provided in section 5 of this revenue procedure to account for the cost of smallwares paid or incurred before the new restaurant opens.

SECTION 4. DEFINITIONS

.01 Trade or Business of Operating a Restaurant or Tavern. For purposes of this revenue procedure, a taxpayer is engaged in the trade or business of operating a restaurant or tavern if the taxpayer's business consists of preparing food and beverages to customer order for immediate on-premises or off-premises consumption. These

businesses include, for example, full-service restaurants; limited-service eating places; cafeterias; special food services, such as food service contractors, caterers, and mobile food services; and, bars, taverns, and other drinking places. For purposes of this revenue procedure, the trade or business of operating a restaurant or tavern also may include food or beverage services at grocery stores, hotels and motels, amusement parks, theaters, casinos, country clubs, and similar social or recreational facilities.

.02 Smallwares. For purposes of this revenue procedure, smallwares consist of the following ten categories of items: (1) Glassware and paper or plastic cups; (2) Flatware (silverware) and plastic utensils; (3) Dinnerware (dishes) and paper or plastic plates; (4) Pots and Pans; (5) Table Top Items; (6) Bar Supplies; (7) Food Preparation Utensils and Tools; (8) Storage Supplies; (9) Service Items; and (10) Small Appliances that cost \$500 or less. Categories 5 through 10 include, but are not limited to, the items listed below:

(5) Table Top Items include items placed on customer tables, such as salt and pepper shakers, cheese shakers, ash trays, teapots, cruets, sugar caddies, tablecloths, napkins, menu holders, menus, vases, candles, and candleholders.

(6) Bar Supplies include mixing glasses, bar strainers, cutting boards, liquor pourers, jiggers, corkscrews, bottle openers, storage bottles, wine and champagne stoppers, bar caddies, wine coolers, decanters, salt and sugar glass rimmers, slow pourers, and malt shakers.

(7) Food Preparation Utensils and Tools include hand utensils (spoons, spatulas, wisks, peelers, etc.), pastry and grill brushes, skimmers, knives, kitchen shears, cutting boards, strainers, colanders, shakers, dippers, measuring cups and spoons, thermometers, gloves, goggles, timers, scales, shaker baskets, salad spinners, lettuce crispers, sifters, pastry bags and tubes, mixing bowls, pot holders, kitchen towels, cheesecloths, and kitchen staff uniforms.

(8) Storage Supplies include food containers, flatware sorters, dish containers, and spice racks.

(9) Service Items include pepper mills, cheese graters, bread boards, pitchers, squeeze dispensers, coffee pots, napkin receptacles, flatware, plate, glass, and mug storage racks, wait staff and self-serve trays, soup and salad bar trays and containers, bus tubs, tray carts, booster seats, and wait staff uniforms.

(10) Small Appliances include iced tea dispensers, can openers, condiment pumps, individual food warmers, heat lamps, slicers, glass washers, electric knife sharpeners, blenders, juicers, and nonindustrial mixers. Small appliances do not include appliances that cost in excess of \$500.

For purposes of this revenue procedure, smallwares do not include office supplies, general purpose cleaning supplies, or general purpose maintenance tools. In addition, smallwares do not include extraordinary items, such as collectibles or other items of significant artistic or intrinsic value, items that are accounted for separately for tax or financial purposes, or items that generally are listed as scheduled property for insurance purposes. Examples of extraordinary items are flatware or dinnerware made of precious metals, and antique vases used for centerpiece or display purposes.

SECTION 5. SMALLWARES METHOD

.01 Taxpayers within the scope of this revenue procedure are permitted to account for smallwares in the same manner as materials and supplies that are not incidental under § 1.162-3.

.02 Under § 1.162-3, the costs of materials and supplies that are not incidental are deductible in the year in which the materials and supplies are actually consumed and used in a taxpayer's business.

.03 For purposes of this revenue procedure, smallwares are consumed and used in a taxpayer's business, within the meaning of § 1.162-3, in the taxable year in which they are received at the restaurant and are available for use. For purposes of this revenue procedure, "received at the restaurant and available for use" does not include smallwares purchased and stored at a warehouse or facility other than the restaurant where the smallwares will be used.

SECTION 6. CHANGE IN METHOD OF ACCOUNTING

.01 Limitations, Terms, and Conditions. A change in a taxpayer's treatment of the cost of smallwares to the smallwares method provided in section 5 of this revenue procedure is a change in method of accounting to which §§ 446 and 481 apply. A taxpayer that wants to change its method of accounting for the cost of smallwares to the smallwares method provided in section 5 of this revenue procedure must follow the automatic change in method of accounting provisions of Rev. Proc. 2002-9, 2002-3 I.R.B (or its successor) with the following modification: the scope limitations in section 4.02 of Rev. Proc. 2002-9 do not apply. However, if a taxpayer is under examination, before an area appeals office, or before a federal court with respect to any income tax issue at the time that a copy of the Form 3115, Application for Change in Accounting Method, is filed with the national office, the taxpayer must provide a copy of the Form 3115 to the examining agent, appeals officer, or counsel for the government, as appropriate, at the same time the copy of the Form 3115 is filed with the national office. The Form 3115 must contain the name(s) and telephone number(s) of the examining agent, appeals officer, or counsel for the government, as appropriate.

.02 Audit Protection. If a taxpayer complies with the requirements of this revenue procedure and changes its method of accounting for the cost of smallwares to the smallwares method provided in section 5 of this revenue procedure, the treatment of those costs will not be raised as an issue in any taxable year before the year of change and, if the treatment of the cost of smallwares has already been raised as an issue in a taxable year before the year of change, that issue will not be further pursued.

.03 Section 481(a) Adjustment. A taxpayer changing its method of accounting under this revenue procedure for the cost of smallwares must take the entire net amount of any § 481(a) adjustment into account in computing taxable income for the year of change.

SECTION 7. EFFECTIVE DATE

This revenue procedure is effective for taxable years ending on or after December 31, 2001.

DRAFTING INFORMATION

The principal author of this revenue procedure is Angella L. Warren of the Office of Associate Chief Counsel (Income Tax and Accounting). For further information regarding this revenue procedure, contact Ms. Warren at (202) 622-4950 (not a toll-free call).