

Part III

Administrative, Procedural, and Miscellaneous

26 CFR 601.204: Changes in accounting periods and methods of accounting.
(Also Part I, §§ 461, 481; 1.461-2.)

Revenue Procedure 2004-31

SECTION 1. PURPOSE

This revenue procedure provides procedures for taxpayers to change their method of accounting for deducting under § 461(f) of the Internal Revenue Code amounts transferred to trusts in transactions described in Notice 2003-77, 2003-49 I.R.B. 1182.

SECTION 2. BACKGROUND

.01 On November 19, 2003, the Internal Revenue Service and Treasury Department filed with the Federal Register proposed and temporary regulations under § 461(f). 68 Fed. Reg. 65634, 65645; 2003-49 I.R.B. 1175, 1191. These regulations clarify that the transfer of a taxpayer's note or promise to provide property or services in the future is not a transfer for the satisfaction of a contested liability under § 461(f). The regulations also provide that a transfer of a taxpayer's stock or the stock or note of a related party is not a transfer for the satisfaction of a contested liability under § 461(f). The regulations further provide that, in general, economic performance does not occur when a taxpayer transfers money or other property to a trust, escrow account, or court to provide for the satisfaction of a contested workers compensation, tort, or other payment liability. Rather, economic performance occurs when payment is made to the claimant.

.02 Notice 2003-77, 2003-49 I.R.B. 1182, identifies as "listed transactions" for purposes of § 1.6011-4(b)(2) of the Income Tax Regulations and §§ 301.6111-2(b)(2) and 301.6112-1(b)(2) of the Procedure and Administration Regulations, transactions in which taxpayers established trusts purported to qualify under § 461(f) that are the same as or substantially similar to the following transactions:

(1) Transactions in which a taxpayer transfers money or other property in taxable years beginning after December 31, 1953, and ending after August 16, 1954, and retains certain powers over the money or other property transferred;

(2) Transactions in which a taxpayer transfers any indebtedness of the taxpayer or any promise by the taxpayer to provide services or property in the future in

taxable years beginning after December 31, 1953, and ending after August 16, 1954;

(3) Transactions in which a taxpayer using an accrual method of accounting transfers money or other property after July 18, 1984, to provide for the satisfaction of a workers compensation or tort liability (unless the trust is the person to which the liability is owed, or payment to the trust discharges the taxpayer's liability to the claimant);

(4) Transactions in which a taxpayer using an accrual method of accounting transfers money or other property in taxable years beginning after December 31, 1991, to provide for the satisfaction of a liability for which payment is economic performance under § 1.461-4(g) (unless the trust is the person to which the liability is owed, or payment to the trust discharges the taxpayer's liability to the claimant), other than a liability for workers compensation or tort; and

(5) Transactions in which a taxpayer transfers stock issued by the taxpayer, or indebtedness or stock issued by a party related to the taxpayer (as defined in § 267(b)), on or after November 19, 2003.

.03 Section 1.6011-4(a) provides that every taxpayer that has participated (as described in § 1.6011-4(c)(3)) in a reportable transaction and that is required to file a tax return must attach a disclosure statement to its return. A reportable transaction includes any transaction that is the same as or substantially similar to one of the types of transactions that the IRS has determined to be a tax avoidance transaction and identified by published guidance as a listed transaction. Section 1.6011-4(b)(2). Generally, a listed transaction is not treated as a reportable transaction if the transaction affected the taxpayer's Federal income tax liability as reported on any tax return filed on or before February 28, 2000. Section 1.6011-4T(b)(2) as published in T.D. 8877 in 65 Fed. Reg. 11205. See also § 1.6011-4(h).

.04 Sections 446(e) and 1.446-1(e) provide 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. Section 1.446-1(e)(3)(i) provides that, to obtain the Commissioner's consent to an accounting 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. Section 1.446-1(e)(3)(ii) authorizes the Commissioner to prescribe administrative procedures setting forth the limitations, terms, and conditions deemed necessary to permit a taxpayer to obtain consent to change a method of accounting in accordance with § 446(e).

.05 Rev. Proc. 97-27, 1997-1 C.B. 680, (as modified and amplified by Rev. Proc. 2002-19, 2002-1 C.B. 696, as amplified and clarified by Rev. Proc. 2002-54, 2002-2 C.B. 432), provides procedures for obtaining the consent of the Commissioner to change a method of accounting for federal income tax purposes. In general, under these procedures a taxpayer must file a Form 3115 during the year of change and may not request or make a retroactive change in method of accounting unless specifically

authorized by the Commissioner. Rev. Proc. 97-27, sections 5.01, 2.04. In addition, under these procedures a taxpayer generally takes into account a positive § 481(a) adjustment resulting from the change in method of accounting ratably over four taxable years and receives audit protection for taxable years prior to the year of change. Rev. Proc. 97-27, sections 5.02(3)(a), 9.01. However, section 8.01 of Rev. Proc. 97-27 states that the Service reserves the right to decline to process a Form 3115 “in situations in which it would not be in the best interest of sound tax administration to permit the requested change. In this regard, the Service will consider whether the change in method of accounting would clearly and directly frustrate compliance efforts of the Service in administering the income tax laws.”

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

.07 A change from deducting an asserted liability in the taxable year of transfer of money or other property to a trust described in Notice 2003-77 to deducting the liability in the taxable year of payment to the claimant is a change in method of accounting. The Service has determined that it is not in the best interest of sound tax administration to permit a prospective change in method of accounting for such deductions in transactions that are required to be disclosed as listed transactions under § 1.6011-4. In addition, in the interest of sound tax administration, the Service has determined that the terms and conditions set forth in Rev. Proc. 97-27 should be modified for changes in methods of accounting for such deductions in transactions that are not required to be disclosed as listed transactions under § 1.6011-4.

SECTION 3. SCOPE

This revenue procedure applies to taxpayers that desire to change a method of accounting for transactions described in section 2.02 of this revenue procedure.

SECTION 4. APPLICATION

.01 Change in method of accounting for transactions described in Notice 2003-77 that are required to be disclosed as listed transactions under § 1.6011-4. The Service will not process applications for changes in method of accounting filed for transactions within the scope of this revenue procedure that are required to be disclosed under § 1.6011-4. Taxpayers may change their method of accounting for these transactions by filing an amended return in accordance with section 4.04 of this revenue procedure.

.02 Change in method of accounting for transactions described in Notice 2003-77 that are not required to be disclosed as listed transactions under § 1.6011-4.

Taxpayers that desire to change a method of accounting for transactions within the scope of this revenue procedure that are not required to be disclosed under § 1.6011-4 may change their method of accounting for these transactions by filing an amended return in accordance with section 4.04 of this revenue procedure or may request a change in method of accounting in accordance with the advance consent procedures of Rev. Proc. 97-27 with the following modifications:

(1) In lieu of the four year spread period for positive § 481(a) adjustments provided in section 5.02(3)(a) of Rev. Proc. 97-27, the taxpayer must take into account the entire amount of a positive § 481(a) adjustment in the taxable year of change; and

(2) The taxpayer must describe each transaction, explain in the Form 3115 why the transaction is not required to be disclosed under § 1.6011-4, and state the amount of § 481(a) adjustment for that transaction.

.03 Change in method of accounting by taxpayers that have engaged in multiple transactions described in Notice 2003-77, some of which are required to be disclosed as listed transactions under § 1.6011-4. A taxpayer changing its method of accounting for multiple transactions within the scope of this revenue procedure, some of which are required to be disclosed under § 1.6011-4 and some of which are not required to be disclosed under § 1.6011-4:

(1) May change its method of accounting for transactions that are not required to be disclosed under § 1.6011-4 in accordance with section 4.02 of this revenue procedure, but must take into account in computing the § 481(a) adjustment only amounts attributable to those transactions; and

(2) Must file amended returns in accordance with sections 4.01 and 4.04 of this revenue procedure to change its method of accounting for all transactions required to be disclosed under § 1.6011-4 prior to filing the Form 3115 for transactions not required to be disclosed.

.04 Change in method of accounting by filing amended return.

(1) In accordance with § 1.446-1(e)(3)(ii) and Rev. Rul. 90-38, consent is hereby granted for any taxpayer that has engaged in a transaction within the scope of this revenue procedure to file amended returns to retroactively change an impermissible method of accounting for amounts transferred to trusts purported to qualify under § 461(f) to a method that complies with § 461(f) and the regulations thereunder. This consent is granted only if the taxpayer files such amended returns for the first taxable year in which the taxpayer used the impermissible method of accounting for these

transactions (or if the period of limitations has expired for such taxable year, for the first taxable year for which the period of limitations has not expired) and for each subsequent taxable year in which the taxpayer's use of the impermissible method of accounting for these transactions reduced the taxpayer's taxable income. If the period of limitations has expired for the first taxable year in which a taxpayer used the impermissible method of accounting for these transactions and the taxpayer files amended returns pursuant to this consent, the amended return for the first taxable year for which the period of limitations has not expired must include the entire amount of the § 481(a) adjustment attributable to the change in accounting method.

(2) A taxpayer that complies with section 4.04(1) of this revenue procedure also may file amended returns for any taxable years in which the taxpayer's use of the impermissible method of accounting for these transactions increased its taxable income.

(3) Taxpayers filing amended returns under this revenue procedure must write "FILED UNDER REVENUE PROCEDURE 2004-31" at the top of the amended return. Taxpayers also must comply with the requirements of § 1.6011-4 including, but not limited to, attaching to the amended return any disclosure statements that may be required in accordance with § 1.6011-4(a) and (e).

SECTION 5. EFFECTIVE DATE

This revenue procedure is effective on May 6, 2004.

DRAFTING INFORMATION

The principal author of this revenue procedure is Norma Rotunno of the Office of the Associate Chief Counsel (Income Tax & Accounting). For further information regarding this notice, contact Ms. Rotunno at (202) 622-7900 (not a toll-free number).