

26 CFR 601.204: Changes in accounting periods and in methods of accounting.
(Also Part I, §§ 263A, 446, 471, 481)

Rev. Proc. 2014-33

SECTION 1. PURPOSE

This revenue procedure provides the exclusive procedures by which a taxpayer obtains the consent of the Commissioner under § 446(e) of the Internal Revenue Code to (1) change its method of accounting for royalties described in § 1.263A-1(e)(3)(ii)(U)(2) of the Income Tax Regulations, (2) change its method of accounting for sales-based vendor chargebacks described in § 1.471-3(e)(1), or (3) change its simplified production method or simplified resale method for costs allocated only to inventory property that has been sold, to comply with final regulations under §§ 263A and 471.

SECTION 2. BACKGROUND

.01 Section 263A requires taxpayers to capitalize the direct costs and indirect costs that are properly allocable to real property or tangible personal property the taxpayer produces and real property or personal property described in § 1221(a)(1) that the taxpayer acquires for resale. Taxpayers must allocate costs required to be capitalized to property produced or acquired for resale during the taxable year using a cost allocation method described in the regulations. For example, taxpayers may use the

simplified methods provided in § 1.263A-2(b) (the simplified production method) or § 1.263A-3(d) (the simplified resale method) to allocate costs to inventory property produced or acquired for resale.

.02 Under § 471, when the use of inventories is necessary to clearly determine the income of any taxpayer, inventories must be taken on the basis that most clearly reflects income. Section 1.471-2(c) permits merchants and manufacturers to value inventories at either (1) cost, or (2) cost or market, whichever is lower. Under § 1.471-3(b), the cost of merchandise purchased by taxpayers is, in general, the invoice price less trade or other discounts.

.03 On January 13, 2014, the Internal Revenue Service and Treasury Department published final regulations under §§ 263A and 471 (TD 9652, 79 Fed. Reg. 2094) relating to (1) the capitalization and allocation of royalties that a taxpayer incurs only upon the sale of property produced or acquired for resale (sales-based royalties), and (2) the adjustment of the cost of inventory for sales-based vendor chargebacks, a type of sales-based vendor allowance. The final regulations apply to taxable years ending on or after January 13, 2014.

.04 Section 1.263A-1(e)(3)(ii)(U) of the final regulations clarifies that sales-based royalties, which are royalties incurred in securing the contractual right to use a trademark, corporate plan, manufacturing procedure, special recipe, or other similar right associated with property produced or property acquired for resale, are indirect costs and are properly allocable to property produced or acquired for resale to the extent the costs directly benefit or are incurred by reason of production or resale activities. Under § 1.263A-1(e)(3)(ii)(U)(2) of the final regulations, a taxpayer may

allocate capitalizable sales-based royalties entirely to the units of property produced or acquired for resale that are sold and, in the case of inventory property, allocate these costs only to cost of goods sold.

.05 Under § 1.263A-1(c)(5) of the final regulations, a cost that is allocated entirely to inventory property sold must be included in cost of goods sold and may not be included in determining the cost of goods on hand at the end of the taxable year.

.06 Section 1.471-3(e)(1) of the final regulations provides that a sales-based vendor chargeback, one type of sales-based vendor allowance, is an allowance or price rebate that reduces only cost of goods sold and does not adjust the cost of goods on hand at the end of the taxable year. A sales-based vendor chargeback is defined as an allowance, discount, or price rebate to which a taxpayer becomes unconditionally entitled by selling a vendor's merchandise to specific customers identified by the vendor at a price determined by the vendor. The final regulations reserve rules addressing other types of sales-based vendor allowances.

.07 The final regulations under §§ 1.263A-2(b) and 1.263A-3(d) revise the simplified production method and the simplified resale method by providing that additional § 263A costs incurred during the taxable year, § 471 costs incurred during the taxable year, and § 471 costs remaining on hand at year end do not include costs specifically described in § 1.263A-1(e)(3)(ii) (currently only capitalizable depletion and sales-based royalties) and cost reductions described in § 1.471-3(e) (such as sales-based vendor chargebacks) that are properly allocated to property that has been sold. Consequently, a taxpayer allocating sales-based royalties or sales-based vendor chargebacks to cost of goods sold and currently including these amounts in § 471 costs or additional § 263A costs

must remove the sales-based royalties or sales-based vendor chargebacks in the same manner that the taxpayer included them. Changes in methods of accounting for depletion under these regulations will be addressed in separate guidance.

.08 Sections 446(e) and 1.446-1(e)(2) state 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)(ii) authorizes the Commissioner to prescribe administrative procedures setting forth the limitations, terms, and conditions necessary to permit a taxpayer to obtain consent to change a method of accounting in accordance with § 446(e).

.09 Rev. Proc. 97-27, 1997-1 C.B. 680, modified and amplified by Rev. Proc. 2002-19, 2002-1 C.B. 696, amplified and clarified by Rev. Proc. 2002-54, 2002-2 C.B. 432, modified by Rev. Proc. 2007-67, 2007-2 C.B. 1072, clarified and modified by Rev. Proc. 2009-39, 2009-38 C.B. 371, modified by Rev. Proc. 2011-14, 2011-4 C.B. 330, and clarified and modified by Rev. Proc. 2012-39, 2012-41 C.B. 470, provides the general procedures for obtaining the advance consent of the Commissioner to change a method of accounting. See also Rev. Proc. 2014-1, 2014-1 I.R.B. 1 (or successor).

.10 Rev. Proc. 2011-14, 2011-1 C.B. 330, provides procedures for a taxpayer to obtain automatic consent of the Commissioner to change to a method of accounting described in the APPENDIX of Rev. Proc. 2011-14.

.11 Section 481(a) requires the adjustments necessary to prevent amounts from being duplicated or omitted when a taxpayer's taxable income is determined under a method of accounting different from the method used to determine taxable income for the preceding taxable year.

SECTION 3. SCOPE

This revenue procedure applies to a taxpayer that wants to make one or more of the accounting method changes described in section 4 of this revenue procedure.

SECTION 4. CHANGES IN METHOD OF ACCOUNTING

.01 Rev. Proc. 2011-14 is modified to add new section 11.11 of the APPENDIX, to read as follows:

.11 *Sales-Based Royalties*

(1) *Description of change.* This change applies to a taxpayer that wants to change its method of accounting for sales-based royalties (as described in § 1.263A-1(e)(3)(ii)(U)(2)) that are properly allocable to inventory property:

(a) From not capitalizing sales-based royalties to capitalizing these costs and allocating them entirely to cost of goods sold under a taxpayer's method of accounting;

(b) From not capitalizing sales-based royalties to capitalizing these costs and allocating them to inventory property under a taxpayer's method of accounting;

(c) From capitalizing sales-based royalties and allocating these costs to inventory property to allocating them entirely to cost of goods sold; or

(d) From capitalizing sales-based royalties and allocating these costs entirely to cost of goods sold to allocating them to inventory property.

(2) *Limitations.*

(a) A taxpayer may not make a change in method of accounting under this section 11.11 of the APPENDIX if the taxpayer wants to change to capitalizing sales-based royalties and allocating them to inventory property using an other reasonable allocation method within the meaning of § 1.263A-1(f)(4).

(b) A taxpayer making the changes described in section 11.11(1)(a) or 11.11(1)(c) of the APPENDIX that uses a simplified method to determine the additional § 263A costs allocable to inventory property on hand at year end must remove sales-based royalties allocated to cost of goods sold from the formulas used to allocate additional § 263A costs to ending inventory in the same manner that the taxpayer included these amounts in the formulas.

(c) A taxpayer making a change in method of accounting under this section 11.11 of the APPENDIX that uses a simplified method with an historic absorption ratio election (see §§ 1.263A-2(b)(4) and 1.263A-3(d)(4)) and currently includes, or is changing its method to include, sales-based royalties in any part of its historic absorption ratio must revise its previous and current historic absorption ratios. To revise its historic absorption ratios, the taxpayer must apply its proposed method of accounting during the test period, during all recomputation years, and during all updated test periods to determine the § 471 costs and additional § 263A costs that were incurred. The revised historic absorption ratios must be used to revalue beginning inventory and must be accounted for in the taxpayer's § 481(a) adjustment. The taxpayer must use a method described in § 1.263A-7(c) to revalue beginning inventory.

(3) *Certain scope limitations temporarily inapplicable.* The scope limitations in section 4.02(1) through (4) and (7) of this revenue procedure do not apply to this change for a taxpayer's first and second taxable years ending on or after January 13, 2014.

(4) *Concurrent automatic changes.* A taxpayer that wants to make a change under this section 11.11 of the APPENDIX and one or more automatic changes in

method of accounting under § 263A for the same year of change may file a single Form 3115 for all changes, provided the taxpayer enters the designated automatic change numbers for all changes on the appropriate line on the Form 3115 and complies with the ordering rules of § 1.263A-7(b)(2).

(5) *Ogden copy of Form 3115 required in lieu of national office copy.* A taxpayer changing its method of accounting under this section 11.11 of the APPENDIX must file a signed copy of its completed Form 3115 with the IRS in Ogden, UT in lieu of filing the national office copy no earlier than the first day of the year of change and no later than the date the taxpayer files the original Form 3115 with its federal income tax return for the year of change. A taxpayer that makes both this change and a concurrent automatic change under § 263A on a single Form 3115 for the same year of change must file a signed copy of the completed Form 3115 with the IRS in Ogden, UT in lieu of filing the national office copy no earlier than the first day of the year of change and no later than the date the taxpayer files the original Form 3115 with its federal income tax return for the year of change. See sections 6.02(3)(a)(ii)(B) (providing the general rules) and 6.02(7)(b) (providing the mailing address) of this revenue procedure.

(6) *Designated automatic accounting method change number.* The designated automatic accounting method change number for changes in method of accounting under section 11.11 of the APPENDIX is No. 201.

(7) *Contact information.* For further information regarding a change under this section, contact John Roman Faron at (202) 317-7005 (not a toll-free call).

.02 Rev. Proc. 2011-14 is modified to add new section 11.12 of the APPENDIX, to read as follows:

.12 Treatment of Sales-Based Vendor Chargebacks under a Simplified Method

(1) *Description of change.* This change applies to a taxpayer that wants to change its method of accounting to no longer include cost adjustments for sales-based vendor chargebacks described in § 1.471-3(e)(1) in the formulas used to allocate additional § 263A costs to ending inventory under a simplified method.

(2) *Limitations.*

(a) A taxpayer making this change that uses a simplified method to determine the additional § 263A costs allocable to inventory property on hand at year end must remove sales-based vendor chargebacks from the formulas used to allocate additional § 263A costs to ending inventory in the same manner that the taxpayer included these amounts in the formulas.

(b) A taxpayer making a change in method of accounting under this section 11.12 of the APPENDIX that uses a simplified method with an historic absorption ratio election (see §§ 1.263A-2(b)(4) and 1.263A-3(d)(4)) and currently includes sales-based vendor chargebacks in any part of its historic absorption ratio must revise its previous and current historic absorption ratio(s). To revise its historic absorption ratios, the taxpayer must apply its proposed method of accounting during the test period, during all recomputation years, and during all updated test periods to determine the § 471 costs and additional § 263A costs that were incurred. The revised historic absorption ratios must be used to revalue beginning inventory and must be accounted for in the taxpayer's § 481(a) adjustment. The taxpayer must use a method described in § 1.263A-7(c) to revalue beginning inventory.

(3) *Certain scope limitations temporarily inapplicable.* The scope limitations in section 4.02(1) through (4) and (7) of this revenue procedure do not apply to this change for a taxpayer's first and second taxable years ending on or after January 13, 2014.

(4) *Concurrent automatic changes.* A taxpayer that wants to make both this change and one or more automatic changes in method of accounting under § 263A, or both this change and the change described in section 21.15 of the APPENDIX for the same taxable year of change may file a single Form 3115 for both changes, provided the taxpayer enters the designated automatic change numbers for all changes on the appropriate line on the Form 3115 and complies with the ordering rules of § 1.263A-7(b)(2).

(5) *Ogden copy of Form 3115 required in lieu of national office copy.* A taxpayer changing its method of accounting under this section 11.12 of the APPENDIX must file a signed copy of its completed Form 3115 with the IRS in Ogden, UT in lieu of filing the national office copy no earlier than the first day of the year of change and no later than the date the taxpayer files the original Form 3115 with its federal income tax return for the year of change. If a taxpayer makes both this change and a concurrent automatic change under § 263A or both this change and the change described in section 21.15 of the APPENDIX on a single Form 3115 for the same year of change, then the taxpayer must file a signed copy of that completed Form 3115 with the IRS in Ogden, UT in lieu of filing the national office copy no earlier than the first day of the year of change and no later than the date the taxpayer files the original Form 3115 with its federal income tax return for the year of change. See sections 6.02(3)(a)(ii)(B) (providing the general

rules) and 6.02(7)(b) (providing the mailing address) of this revenue procedure.

(6) *Designated automatic accounting method change number.* The designated automatic accounting method change number for changes in method of accounting under section 11.12 of the APPENDIX is No. 202.

(7) *Contact information.* For further information regarding a change under this section, contact John Roman Faron at (202) 317-7005 (not a toll-free call).

.03 Rev. Proc. 2011-14 is modified to add new section 21.15 of the APPENDIX, to read as follows:

.15 Sales-Based Vendor Chargebacks

(1) *Description of change.* This change applies to a taxpayer that wants to change its method of accounting to treat sales-based vendor chargebacks as a reduction in cost of goods sold in accordance with § 1.471-3(e)(1).

(2) *Certain scope limitations temporarily inapplicable.* The scope limitations in section 4.02(1) through (4) and (7) of this revenue procedure do not apply to this change for a taxpayer's first and second taxable years ending on or after January 13, 2014.

(3) *Concurrent automatic changes.* A taxpayer that wants to make both this change and the change described in section 11.12 of the APPENDIX for the same taxable year of change may file a single Form 3115 for both changes, provided the taxpayer enters the designated automatic change numbers for both changes on the appropriate line on the Form 3115, and complies with the ordering rules of § 1.263A-7(b)(2).

(4) *Ogden copy of Form 3115 required in lieu of national office copy.* A taxpayer changing its method of accounting under this section 21.15 of the APPENDIX must file a signed copy of its completed Form 3115 with the IRS in Ogden, UT in lieu of filing the national office copy no earlier than the first day of the year of change and no later than the date the taxpayer files the original Form 3115 with its federal income tax return for the year of change. If a taxpayer makes both this change and a concurrent automatic change described in section 11.12 of the APPENDIX on a single Form 3115 for the same year of change, then the taxpayer must file a signed copy of that completed Form 3115 with the IRS in Ogden, UT in lieu of filing the national office copy no earlier than the first day of the year of change and no later than the date the taxpayer files the original Form 3115 with its federal income tax return for the year of change. See sections 6.02(3)(a)(ii)(B) (providing the general rules) and 6.02(7)(b) (providing the mailing address) of this revenue procedure.

(5) *Designated automatic accounting method change number.* The designated automatic accounting method change number for changes in methods of accounting under section 21.15 of the APPENDIX is 203. See section 6.02(4) of this revenue procedure.

(6) *Contact information.* For further information regarding a change under this section, contact John Roman Faron at (202) 317-7005 (not a toll-free call).

SECTION 5. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 2011-14 is modified to add new sections 11.11, 11.12, and 21.15 to the APPENDIX.

SECTION 6. EFFECTIVE DATE

.01 *In general.* Except as provided in section 6.02 of this revenue procedure, this revenue procedure is effective for taxable years ending on or after January 13, 2014.

.02 *Transition rule.* If before May 6, 2014, a taxpayer properly filed an application under Rev. Proc. 97-27 requesting consent for a change in method of accounting described in section 4 of this revenue procedure, and the Form 3115 is pending with the national office on May 6, 2014, the taxpayer may make the change under this revenue procedure if the taxpayer is otherwise eligible. The taxpayer must notify the national office of its intent to make the change under this revenue procedure prior to the issuance of a letter ruling granting or denying consent for the change. If the taxpayer timely notifies the national office that it will make the change under this revenue procedure, the national office ordinarily will return the Form 3115 to the taxpayer to make the necessary modifications to comply with the applicable provisions of this revenue procedure and will refund the user fee submitted with the Form 3115. A Form 3115 that is returned to the taxpayer for necessary modifications will be converted to an application under this revenue procedure if the taxpayer resubmits the Form 3115 with the necessary modifications, along with a copy of the national office letter sent with the returned Form 3115, to the national office within 30 calendar days after the date of the IRS's letter returning the Form 3115 to the taxpayer.

SECTION 7. DRAFTING INFORMATION

The principal author of this revenue procedure is John Roman Faron of the Office of Associate Chief Counsel (Income Tax and Accounting). For further information regarding this revenue procedure, contact Mr. Faron at (202) 317-7005 (not a toll-free call).