

26 CFR 601.204: Changes in accounting periods and methods of accounting.
(Also Part 1, §§ 162, 263A, 446, 447, 448, 460, 471, 481, 1001; 1.162-3, 1.263A-1, 1.446-1, 1.448-1T, 1.460-1, 1.471-1, 1.481-1, 1.481-4, 1.1001-1.)

Rev. Proc. 2018-40

SECTION 1. PURPOSE

Section 13102 of “An Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018,” P.L. 115-97 (the “Act”), amended § 448 of the Internal Revenue Code (Code) to expand the number of small business taxpayers eligible to use the cash receipts and disbursements method of accounting (cash method). Section 13102 of the Act also amended the Code to exempt small business taxpayers from the requirements to capitalize costs, including for certain home construction contracts, under § 263A, to account for certain long-term contracts under § 460, and to account for inventories under § 471. This revenue procedure provides the procedures by which a small business taxpayer may obtain automatic consent to change its methods of accounting to reflect these statutory changes and requests comments containing suggestions for future guidance under §§ 263A, 447, 448, 460, and 471 to implement section 13102 of the Act.

SECTION 2. BACKGROUND

.01 Section 13102 of the Act amended §§ 263A, 447, 448, 460, and 471 for small

business taxpayers, increasing the gross receipts test amount for eligibility to use the cash method and providing an exemption from the requirements to apply certain method of accounting rules for inventories, cost capitalization, and long-term contracts. These amendments generally apply to taxable years beginning after December 31, 2017. The amendments to § 460 apply to contracts entered into after December 31, 2017, in taxable years ending after December 31, 2017.

.02 Except as otherwise expressly provided by the Code or the regulations, § 446(e) and § 1.446-1(e)(2) require a taxpayer to 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 that provide the terms and conditions necessary for a taxpayer to obtain consent to a change in method of accounting. Rev. Proc. 2015-13, 2015-5 I.R.B. 419, as clarified and modified by Rev. Proc. 2015-33, 2015-24 I.R.B. 1067, as modified by Rev. Proc. 2016-1, 2016-1 I.R.B. 1, and as modified by Rev. Proc. 2017-59, 2017-48 I.R.B. 543, provides the general procedures by which a taxpayer may obtain automatic consent of the Commissioner to a change in method of accounting described in the List of Automatic Changes. Rev. Proc. 2018-31, 2018-22 I.R.B. 637, contains the List of Automatic Changes. Section 3 of this revenue procedure modifies Rev. Proc. 2018-31 to provide additional automatic changes in method of accounting and to modify existing automatic changes in method of accounting to assist taxpayers in conforming to the legislative changes to §§ 263A, 447, 448, 460, and 471.

.03 The Department of the Treasury (Treasury Department) and the Internal

Revenue Service (the Service) also expect to publish future guidance to implement the legislative changes to §§ 263A, 447, 448, 460, and 471. Section 5 of this revenue procedure requests public comments for future guidance in this area.

SECTION 3. CHANGE IN METHOD OF ACCOUNTING

.01 In general. A taxpayer that wants to change to one or more of the methods of accounting described in this revenue procedure must, if eligible, use the automatic change procedures in Rev. Proc. 2015-13 and Rev. Proc. 2018-31 (or any successors), as modified by this revenue procedure.

.02 Modifications to add new sections in Rev. Proc. 2018-31.

(1) Section 15 of Rev. Proc. 2018-31 is modified to add a new section 15.18 to read as follows:

.18 Small business taxpayer changing to overall cash method.

(1) Description of change. This change applies to a small business taxpayer, as defined in section 15.18(5)(a) of this revenue procedure, that wants to change its overall method of accounting from an overall accrual method of accounting to the overall cash method of accounting for a trade or business, and is otherwise not prohibited from using the overall cash method or required to use another overall method of accounting. A small business taxpayer may be required to use a method of accounting (other than the cash method) for one or more items of income or expense under certain provisions of the Code or regulations, including, for example §§ 475 and 1272.

(2) Applicability. This section 15.18 is effective for taxable years beginning after December 31, 2017.

(3) Inapplicability. This change does not apply to the following:

(a) Banks changing to overall cash/hybrid method. This change does not apply to a bank described in section 15.12(2)(a) of this revenue procedure. However, such a bank may be eligible to change to the overall cash/hybrid method under section 15.12 of this revenue procedure if it meets the requirements of that section.

(b) Farmers changing to overall cash method. This change does not apply to a farming business changing to the overall cash method. See, however, section 15.13 of this revenue procedure.

(4) Special rules for open accounts receivables. Notwithstanding § 1001 and the accompanying regulations, a small business taxpayer that uses the overall cash method for a trade or business includes amounts attributable to open accounts receivable (as defined in section 15.18(5)(c) of this revenue procedure) in income as the amounts are actually or constructively received on the receivables.

(5) Definitions.

(a) Small business taxpayer. A small business taxpayer is a taxpayer, other than a tax shelter (as defined in § 448(d)(3)), that meets the § 448(c) gross receipts test.

(b) Section 448(c) gross receipts test. The § 448(c) gross receipts test is met if a taxpayer has average annual gross receipts for the three prior taxable years of \$25,000,000 or less (adjusted for inflation).

(c) Open accounts receivable. For purposes of this section 15.18, an open accounts receivable is any receivable that is due in full in 120 days or less and that is not subject to § 475.

(6) Certain eligibility rule temporarily inapplicable. The eligibility rule in section 5.01(1)(e) of Rev. Proc. 2015-13 does not apply to this change for a taxpayer's first, second, or third taxable year beginning after December 31, 2017.

(7) Reduced filing requirement. A taxpayer is required to complete only the following information on Form 3115 (Rev. December 2015) to make this change:

- (a) The identification section of page 1 (above Part I);
- (b) The signature section at the bottom of page 1;
- (c) Part I;
- (d) Part II, all lines except line 16;
- (e) Part IV, all lines except line 25; and
- (f) Schedule A, Part I, all lines except lines 3, 4, and 5.

(8) Concurrent automatic changes. A taxpayer making a change to the overall cash method under this section 15.18 and a change under sections 12.16 and/or 22.19 of this revenue procedure for the same year of change may file a single Form 3115 for all changes, provided the taxpayer enters the designated automatic accounting method change numbers for the changes on the appropriate line of Form 3115. See section 6.03(1)(b) of Rev. Proc. 2015-13 for information on making concurrent changes.

(9) Designated automatic accounting method change number. The designated automatic accounting method change number for a change under this section 15.18 is “233.”

(10) Contact information. For further information regarding a change under this section, contact Anna Gleysteen at (202) 317-7007 (not a toll-free call).

(2) Section 12 of Rev. Proc. 2018-31 is modified to add a new section 12.16 to read as follows:

.16 Small business taxpayer exception from requirement to capitalize costs under § 263A.

(1) Description of change. This change applies to a small business taxpayer, as defined in section 15.18(5)(a) of this revenue procedure, that capitalizes costs under § 263A and wants to change to a method of accounting that no longer capitalizes costs under § 263A, including to self-constructed assets, pursuant to § 263A(i).

(2) Applicability. This change is effective for taxable years beginning after December 31, 2017.

(3) Inapplicability. This change does not apply to a small business taxpayer, as defined in section 15.18(5)(a) of this revenue procedure, that chooses to no longer capitalize costs under § 263A for home construction contracts, as defined in § 460(e)(1)(A). See, however, section 19.01 of this revenue procedure.

(4) Certain eligibility rule temporarily inapplicable. The eligibility rule in section 5.01(1)(f) of Rev. Proc. 2015-13 does not apply for a taxpayer’s first, second, or third taxable year beginning after December 31, 2017.

(5) Reduced filing requirement. A taxpayer is required to complete only the following information on Form 3115 (Rev. December 2015) to make this change:

- (a) The identification section of page 1 (above Part I);
- (b) The signature section at the bottom of page 1;
- (c) Part I;
- (d) Part II, all lines except line 16; and
- (e) Part IV, all lines except line 25.

(6) Concurrent automatic changes. A taxpayer making a change under this section 12.16 and a change under sections 15.18 and/or 22.19 of this revenue procedure for the same year of change may file a single Form 3115 for all changes, provided the taxpayer enters the designated automatic accounting method change numbers for the changes on the appropriate line of Form 3115. See section 6.03(1)(b) of Rev. Proc. 2015-13 for information on making concurrent changes.

(7) Designated automatic accounting method change number. The designated automatic accounting method change number for a change under this section 12.16 is “234.”

(8) Contact information. For further information regarding a change under this section, contact Natasha Mulleneaux at (202) 317-7007 (not a toll-free call).

(3) Section 22 of Rev. Proc. 2018-31 is modified to add a new section 22.19 to read as follows:

.19 Small business taxpayer exception from requirement to account for inventories under § 471.

(1) Description of change. This change applies to a small business taxpayer, as defined in section 15.18(5)(a) of this revenue procedure, that wants to change its § 471 method of accounting for inventory items to one of the following:

(a) treating inventory as non-incidentals materials and supplies under § 1.162-3; or

(b) conforming to the taxpayer's method of accounting reflected in its applicable financial statements, as defined in § 451(b)(3), with respect to the taxable year, or if the taxpayer does not have an applicable financial statement for the taxable year, the books and records of the taxpayer prepared in accordance with the taxpayer's accounting procedures.

(2) Applicability. This change is effective for taxable years beginning after December 31, 2017.

(3) Certain eligibility rule temporarily inapplicable. The eligibility rule in section 5.01(1)(f) of Rev. Proc. 2015-13 does not apply to this change for a taxpayer's first, second, or third taxable year beginning after December 31, 2017.

(4) Reduced filing requirement. A taxpayer is required to complete only the following information on Form 3115 (Rev. December 2015) to make this change:

(a) The identification section of page 1 (above Part I);

(b) The signature section at the bottom of page 1;

(c) Part I;

(d) Part II, all lines except line 16; and

(e) Part IV, all lines except line 25.

(5) No ruling on method of accounting used. The consent granted under section 9 of Rev. Proc. 2015-13 for a change made under section 22.19(1)(b) of this revenue procedure is not a determination by the Commissioner that the proposed inventory method of accounting is permissible, and does not create any presumption that the proposed method is a permissible method of accounting under a provision of the Code. The director will ascertain whether the proposed method is permissible under the Code.

(6) Concurrent automatic changes. A taxpayer making a change under this section 22.19 and a change under sections 15.18 and/or 12.16 of this revenue procedure for the same year of change may file a single Form 3115 for all changes, provided the taxpayer enters the designated automatic accounting method change numbers for the changes on the appropriate line of Form 3115. See section 6.03(1)(b) of Rev. Proc. 2015-13 for information on making concurrent changes.

(7) Designated automatic accounting method change number. The designated automatic accounting method change number for a change under this section 22.19 is “235.”

(8) Contact information. For further information regarding a change under this section, contact Andrew Braden at (202) 317-7007 (not a toll-free call).

(4) Section 19 of Rev. Proc. 2018-31 is modified to add a new section 19.01 to read as follows:

.01 Small business taxpayer exceptions from requirement to account for certain long-term contracts under § 460 or to capitalize costs under § 263A for certain home construction contracts.

(1) Description of Change. This change applies to a taxpayer that, beginning in the year of change, qualifies as a small business taxpayer, as defined in section 15.18(5)(a) of this revenue procedure, and (a) wants to change its method of accounting for exempt long-term construction contracts described in § 460(e)(1)(B) from the percentage-of-completion method of accounting described in § 1.460-4(b) to an exempt contract method of accounting described in § 1.460-4(c), or (b) chooses to stop capitalizing costs under § 263A for home construction contracts defined in § 460(e)(1)(A).

(2) Applicability. This change applies to exempt long-term contracts described in § 460(e)(1) that are entered into after December 31, 2017, in taxable years ending after December 31, 2017.

(3) Inapplicability. A taxpayer can use a method of accounting for its exempt long-term contracts that is different from the method used for contracts that are not exempt. Thus, a taxpayer must use the percentage-of-completion method of accounting for nonresidential long-term construction contracts entered into in the first taxable year that the taxpayer fails the § 448(c) gross receipts test, but must continue to use its exempt contract method of accounting for its existing exempt long-term construction contracts. Similarly, in the taxable year that a taxpayer first meets the § 448(c) gross receipts test, the taxpayer can use a permissible exempt contract

method of accounting for long-term construction contracts it expects to complete within two years. Rev. Rul. 92-28, 1992-1 C.B. 153. Accordingly, only a taxpayer who previously adopted the percentage-of-completion method of accounting for exempt long-term construction contracts and wants to change to another permissible exempt contract method of accounting is required to request consent to change under this section 19.01. Similarly, a taxpayer that meets the § 448(c) gross receipts test and enters into a home construction contract that it expects to complete within two years requires consent to change its method of accounting to not capitalize costs under § 263A only if the taxpayer has previously applied § 263A to home construction contracts exempt from the capitalization requirement under § 460(e)(1).

(4) Manner of making change. This change is made on a cut-off basis and applies only to long-term construction contracts entered into after December 31, 2017, in taxable years ending after December 31, 2017. Accordingly, a § 481(a) adjustment is neither permitted nor required.

(5) Certain eligibility rule temporarily inapplicable. The eligibility rule in section 5.01(1)(f) of Rev. Proc. 2015-13 does not apply to this change for a taxpayer's first, second, or third taxable year ending after December 31, 2017.

(6) Reduced filing requirement. A taxpayer is required to complete only the following information on Form 3115 (Rev. December 2015) to make this change:

- (a) The identification section of page 1 (above Part I);
- (b) The signature section at the bottom of page 1;
- (c) Part I;

(d) Part II, all lines except line 16;

(e) Part IV, line 25; and

(e) Schedule D, Part I.

(7) Designated automatic accounting method change number. The designated automatic accounting method change number for a change under this section 19.01 is “236.”

(8) Contact information. For further information regarding changes under this section, contact Innessa Glazman at (202) 317-7006 (not a toll-free call).

.03 Modifications to existing sections in Rev. Proc. 2018-31.

(1) Section 12.01(1)(b)(v) of Rev. Proc. 2018-31 is modified to read as follows:

(v) Certain change with limited applicability. A small reseller, as defined in section 12.01(3)(b) of this revenue procedure, is not permitted to make a change in method of accounting described in section 12.01(1)(a)(i) of this revenue procedure for a taxable year beginning after December 31, 2017. See, however, section 12.16 of this revenue procedure for making a change in method of accounting not to apply § 263A and section 22.19 of this revenue procedure for making a change in method of accounting for inventories for taxable years beginning after December 31, 2017.

(2) Section 15.03(1)(b) of Rev. Proc. 2018-31 is modified to read as follows:

(b) Inapplicability. This change does not apply for any taxable year beginning after December 31, 2017. See, however, section 15.18 of this revenue procedure for making a change in method of accounting to the overall cash method for taxable years beginning after December 31, 2017.

(3) Section 15.13 of Rev. Proc. 2018-31 is modified to renumber existing paragraphs (3) through (5) as paragraphs (4) through (6), and add new paragraph (3) to read as follows:

(3) Certain eligibility rule temporarily inapplicable. The eligibility rule in section 5.01(1)(e) of Rev. Proc. 2015-13 does not apply to this change for a taxpayer's first, second, or third taxable year beginning after December 31, 2017.

(4) Section 22.03(1)(b) of Rev. Proc. 2018-31 is modified to read as follows:

(b) Inapplicability. This change does not apply for taxable years beginning after December 31, 2017. See, however, section 22.19 of this revenue procedure for making a change in method of accounting for inventories for taxable years beginning after December 31, 2017.

.04 Existing § 481(a) adjustment.

If a taxpayer is taking into account a § 481(a) adjustment resulting from a prior, but related, change in method of accounting at the time it changes its method of accounting described in section 3 of this revenue procedure, the taxpayer may account for the prior § 481(a) adjustment separately from the § 481(a) adjustment required by a change in method of accounting described in section 3 of this revenue procedure. For example, a taxpayer that changed from the cash method to an overall accrual method in a prior year and was required to take the relevant § 481(a) adjustment into account over four years could continue to take into account any remaining adjustment over the appropriate number of years even if the taxpayer changes to the cash method in the current year under section 3 of this revenue procedure. However, the taxpayer may

also choose to combine or net the remaining portion of the prior § 481(a) adjustment with the § 481(a) adjustment required by the change in method of accounting made under section 3 of this revenue procedure. Any taxpayer choosing to combine or net the § 481(a) adjustments indicates this choice in the statement required on Line 26 on the Form 3115, Application for Change in Accounting Method, (Rev. December 2015) required to be filed to make the change(s) in method of accounting under section 3 of this revenue procedure.

SECTION 4. TRANSITION RULE

If before Aug. 3, 2018, a taxpayer properly filed a Form 3115 under the non-automatic change procedures in Rev. Proc. 2015-13 requesting the Commissioner's consent for a change in method of accounting described in section 3 of this revenue procedure, and the Form 3115 is pending with the national office on Aug. 3, 2018, the taxpayer may choose to make the change in method of accounting under the automatic change procedures in Rev. Proc. 2015-13 if the taxpayer is otherwise eligible to use this revenue procedure and the automatic change procedures in Rev. Proc. 2015-13. The taxpayer must notify the national office contact person for the Form 3115 (if unknown, see section 9.08(6) of Rev. Proc. 2018-1, 2018-1 I.R.B. 1, 50 (or any successor)) of the taxpayer's intent to make the change in method of accounting under the automatic change procedures in Rev. Proc. 2015-13 before the later of (a) Sept. 2, 2018, or (b) the issuance of a letter ruling granting or denying consent for the change. The notification should indicate that the taxpayer chooses to convert the Form 3115 to the automatic change procedures in Rev. Proc. 2015-13. If the taxpayer timely notifies the national

office that it chooses to convert the Form 3115 to the automatic change procedures in Rev. Proc. 2015-13, the national office will send a letter to the taxpayer acknowledging its request and will return the user fee submitted with the Form 3115.

A taxpayer converting a Form 3115 to the automatic change procedures in Rev. Proc. 2015-13 for a change in method of accounting described in this revenue procedure must resubmit a Form 3115 that conforms to the automatic change procedures, with a copy of the national office letter sent acknowledging the taxpayer's request attached, to the Service in Covington, KY by the earlier of (a) the 30th calendar day after the date of the national office's letter acknowledging the taxpayer's request, or (b) the date the taxpayer is required to file the duplicate copy of the Form 3115 under section 6.03(1)(a)(i)(B) of Rev. Proc. 2015-13. See section 6.03(3) of Rev. Proc. 2015-13 regarding additional required copies of Form 3115.

For purposes of the eligibility rules in section 5 of Rev. Proc. 2015-13, the duplicate copy of the timely resubmitted Form 3115 will be considered filed as of the date the taxpayer originally filed the converted Form 3115 under the non-automatic change procedures in Rev. Proc. 2015-13. This section 4 does not extend the date the taxpayer must file the original (converted) Form 3115 under section 6.03(1)(a)(i)(A) of Rev. Proc. 2015-13.

SECTION 5. REQUEST FOR COMMENTS AND CONTACT INFORMATION

The Treasury Department and the Service invite comments containing suggestions for future guidance under §§ 263A, 447, 448, 460, and 471 to implement section 13102 of the Act. In particular, comments are requested concerning the

following issues: (1) how the § 448(c) gross receipts test applies to each trade or business of a taxpayer that is not a corporation or partnership; (2) how “books and records of the taxpayer prepared in accordance with the taxpayer’s accounting procedures” should be interpreted in § 471(c)(1)(B); and (3) how to interpret § 460(e)(2)(B) in the context of Rev. Rul. 92-28, 1992-1 C.B. 153.

Comments may be submitted using one of the following methods:

- By Mail:

Internal Revenue Service
Attn: CC:PA:LPD:PR (Rev. Proc. 2018-40)
Room 5203
P.O. Box 7604
Ben Franklin Station
Washington, D.C. 20444

- By Hand or Courier Delivery: Submission may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to:

Courier's Desk
Internal Revenue Service
Attn: CC:PA:LPD:PR
(Rev. Proc. 2018-40)
1111 Constitution Avenue, N.W.
Washington, DC 20224

- Electronic: Alternatively, persons may submit comments electronically to Revenue.Procedure.Comments@irs.counsel.treas.gov. Please include “Rev. Proc. 2018-40” in the subject line of any electronic communications.

All submissions will be available for public inspection and copying.

SECTION 6. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 2018-31 is modified and amplified. Rev. Proc. 2002-28, 2002-18 I.R.B. 815, and Rev. Proc. 2001-10, 2001-2 I.R.B. 272, are obsoleted for taxable years beginning after December 31, 2017.

SECTION 7. EFFECTIVE DATE

Except as otherwise provided in this section, this revenue procedure is effective for taxable years beginning after December 31, 2017. For method changes described in section 3.02(4) of this revenue procedure, this revenue procedure is effective for exempt long-term contracts entered into after December 31, 2017, in taxable years ending after December 31, 2017.

DRAFTING INFORMATION

The principal authors of this revenue procedure are Kari Fisher and Anna Gleysteen of the Office of Associate Chief Counsel (Income Tax and Accounting). For further information regarding this revenue procedure, contact Ms. Fisher at (202) 317-7007. For further information regarding the request for comments contained in this revenue procedure, contact Ms. Gleysteen at (202) 317-7007 (not a toll-free call).