

[4830-01-p]

Published December 12, 2005

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Parts 1 and 301

REG-107722-00

RIN 1545-AY22

Corporate Estimated Tax

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Partial withdrawal of previous proposed rules, notice of proposed rulemaking, and notice of public hearing.

SUMMARY: This document withdraws proposed regulations relating to corporate estimated taxes. This document also contains new proposed regulations that provide guidance to corporations with respect to estimated tax requirements. These proposed regulations generally affect corporate taxpayers who are required to make estimated tax payments. These proposed amendments reflect changes to the law since 1984. This document also provides notice of a public hearing on these proposed regulations.

DATES: Written or electronic comments must be received by February 22, 2006. Outlines of topics to be discussed at the public hearing scheduled for March 15, 2006, must be received by February 22, 2006.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG-107722-00), room 5203, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered Monday

through Friday between the hours of 8 a.m. and 4 p.m. to:

CC:PA:LPD:PR (REG-107722-00), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, DC, or sent electronically, via the IRS Internet site at www.irs.gov/regs or via the Federal eRulemaking Portal at www.regulations.gov (IRS-REG-107722-00). The public hearing will be held in the Auditorium, Internal Revenue Service Building, 1111 Constitution Avenue, NW., Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Joseph P. Dewald, (202) 622-4910; concerning the submissions of comments, the hearing, and/or to be placed on the building access list to attend the hearing, Robin Jones at (202) 622-7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background and Explanation of Provisions

This document withdraws §§1.6152-1(a)(1), 1.6654-2(d)(1)(i), 1.6655-1, 1.6655-2, 1.6655-3, 1.6655-4, 1.6655-5, 1.6655-6, and 301.6655-1 in the notice of proposed rulemaking (LR-228-82) relating to corporate estimated taxes under section 6655 that was published in the **Federal Register** (49 FR 11186) on March 26, 1984 (referred to as the 1984 proposed regulations). This document also contains new proposed amendments to the Income Tax Regulations (26 CFR Part 1) and the Procedure and Administration Regulations (26 CFR Part 301)

relating to corporate estimated taxes under section 6425 and section 6655 of the Internal Revenue Code. The IRS is withdrawing the 1984 proposed regulations because significant changes to the law since 1984 have caused them to become outdated.

These proposed regulations reflect changes to the law made by the Deficit Reduction Act of 1984, Public Law 98-369 (98 Stat. 494), the Superfund Amendments and Reauthorization Act of 1986, Public Law 99-499 (100 Stat. 1613), the Tax Reform Act of 1986, Public Law 99-514 (100 Stat. 2085), the Omnibus Budget Reconciliation Act of 1987, Public Law 100-203 (101 Stat. 1330), the Revenue Act of 1987, Public Law 100-203 (101 Stat. 1330-382), the Omnibus Trade and Competitiveness Act of 1988, Public Law 100-418 (102 Stat. 1107), the Technical and Miscellaneous Revenue Act of 1988, Public Law 100-647 (102 Stat. 3342), the Omnibus Budget Reconciliation Act of 1989, Public Law 101-239 (103 Stat. 2106), the Omnibus Budget Reconciliation Act of 1990, Public Law 101-508 (104 Stat. 1388), the Tax Extension Act of 1991, Public Law 102-227 (105 Stat. 1686), the Act of Feb. 7, 1992, Public Law 102-244 (106 Stat. 3), the Unemployment Compensation Amendments of 1992, Public Law 102-318 (106 Stat. 290), the Omnibus Budget Reconciliation Act of 1993, Public Law 103-66 (107 Stat. 312), the Uruguay Round Agreements Act of 1994, Public Law 103-465 (108 Stat. 4809), the Small Business Job Protection Act of 1996, Public Law 104-188 (110 Stat. 1755), the

Taxpayer Relief Act of 1997, Public Law 105-34 (111 Stat. 788), the Ticket to Work and Work Incentives Improvement Act of 1999, Public Law 106-170 (113 Stat. 1860), the Community Renewal Tax Relief Act of 2000, Public Law 106-554 (114 Stat. 2763), the Economic Growth and Tax Relief Reconciliation Act of 2001, Public Law 107-16 (115 Stat. 38), the Jobs and Growth Tax Relief Reconciliation Act of 2003, Public Law 108-27 (117 Stat. 752), and the American Jobs Creation Act of 2004, Public Law 108-357 (118 Stat. 1418).

The existing regulations under section 6655 do not reflect significant changes to the tax law since 1984, most notably the enactment of the economic performance rules under section 461(h). Since the enactment of section 461(h), the determination of when economic performance must occur for taxpayers to take a deduction into account for purposes of computing a quarterly estimated tax payment has been unclear, particularly for taxpayers that compute their quarterly estimated tax payments using an annualization method.

In addition, the IRS and Treasury Department have become aware of techniques employed by taxpayers, particularly those taxpayers computing their estimated tax payments using an annualization method, that reduce, if not eliminate, estimated tax payments for one or more installments for a taxable year. The proposed regulations provide rules that the IRS and Treasury Department

believe result in a more accurate reflection of annualized income than methods that taxpayers may currently be employing. For example, the proposed regulations make it clear that taxpayers may not, for any purpose, determine taxable income for an annualization period or an adjusted seasonal installment period as though the period is a short taxable year. The proposed regulations provide specific rules for determining taxable income for any annualization period, including how section 461(h) is to be applied in computing taxable income for any annualization period. For example, with respect to an item of income or gain, the proposed regulations provide that the item must be taken into account in computing annualized taxable income for a particular annualization period if the item is includible in computing taxable income in accordance with section 451 on or before the last day of the annualization period. With respect to an item of deduction, the proposed regulations generally provide that an accrual method taxpayer may take into account a deduction in computing annualized taxable income for a particular annualization period only to the extent the item is incurred under §1.461-1(a)(2) on or before the last day of the annualization period. For purposes of determining whether a deduction may be taken into account by an accrual method taxpayer in determining annualized taxable income for a particular annualization period, the provisions of section 170(a)(2) and §1.170A-11(b)

(charitable contributions by accrual method corporations), §1.461-4(d)(6)(ii) (provision of services or property to a taxpayer), §1.461-5 (recurring item exception), and any other provision that has a similar effect are not taken into account in determining whether the item of deduction has been incurred under §1.461-1(a)(2) and is deductible in computing annualized taxable income for an annualization period.

Revenue Ruling 76-450 (1976-2 C.B. 444), provides that state property tax and franchise tax are deductible from the income for an annualization period on the date the taxpayer accrues the taxes under the taxpayer's method of accounting. Revenue Ruling 76-450 was issued prior to the enactment of section 461(h) and does not take into account the application of the economic performance requirements of section 461(h) for purposes of computing an estimated tax payment using the annualized income installment method. The proposed regulations address the application of section 461(h) for purposes of the annualized income installment method and provide that a taxpayer using an accrual method of accounting cannot take a deduction into account unless the deduction has been incurred under §1.461-1(a)(2) and is otherwise deductible in computing taxable income for the applicable annualization period. As a result of the rules provided in the proposed regulations regarding the application of section 461(h) to the annualized income installment

method, Rev. Rul. 76-450 is no longer applicable and will be obsolete when these regulations are effective.

For purposes of section 404 and the regulations, regardless of the overall method of accounting employed by the taxpayer, the applicable 2-, 3-, 4-, 5-, 6-, 7-, 8-, 9-, 10- or 11-month annualization period shall not be treated as a short taxable year and the rules of section 404 and the regulations shall be applied on the basis of the taxpayer's taxable year for which estimated tax is being determined. Thus, the determination of whether a payment to an employee is deferred compensation under §1.404(b)-1T shall be made by reference to whether the payment is received by the employee more than a brief period of time after the last day of the taxable year for which estimated tax is being determined, and not the last day of the annualization period. With respect to contributions to qualified plans governed by section 404 and the regulations, in determining whether an item is paid or incurred by the end of an annualization period, economic performance is satisfied only to the extent such item is paid by the last day of the annualization period (without regard to section 404(a)(6)) and does not, in combination with other such items paid during the annualization period, exceed the applicable deduction limit of section 404(a) for the taxable year. For purposes of sections 419 and 419A and the regulations, regardless of the overall method of accounting employed by the

taxpayer, the applicable 2-, 3-, 4-, 5-, 6-, 7-, 8-, 9-, 10-, or 11-month annualization period shall not be treated as a short taxable year and the rules of sections 419 and 419A and the regulations shall be applied on the basis of the taxpayer's taxable year for which estimated tax is being determined. With respect to contributions to a welfare benefit fund governed by sections 419 and 419A and the regulations, in determining whether an item is paid or incurred by the end of an annualization period, economic performance is satisfied only to the extent such item is paid by the last day of the applicable annualization period and does not, in combination with other such items paid during the annualization period, exceed the applicable deduction limit of section 419 for the taxable year.

The proposed regulations provide guidance for annual expenses paid or incurred at the end of the taxable year, or after the end of the taxable year that are deemed paid or incurred during the taxable year. Section 1.6655-2(f)(2)(i) of the proposed regulations provides that if an accrual method taxpayer has a history of incurring a specific item of expense (or paying a specific item of expense, in the case of a cash method taxpayer) that, while attributable to income earned throughout the current taxable year, is not incurred (or paid, in the case of a cash method taxpayer) until the end of the taxable year or after the end of the current taxable year and is deemed incurred (or paid, in the case of a cash

method taxpayer) during the current taxable year (taking into account, as applicable, section 170(a)(2) and §1.170A-11(b), section 404(a)(6), §1.461-4(d)(6)(ii), §1.461-5, and any other provision that has a similar effect), then the taxpayer may take into account a proportionate part of the specific item of expense for each annualization period. In such case the taxpayer may take into account a proportionate part of the specific item of expense for each annualization period only if the portion of the annual expense taken into account is determined with reasonable accuracy and the expense is properly deducted by the taxpayer for the current taxable year under the taxpayer's method of accounting. For purposes of §1.6655-2(f)(2)(i), a taxpayer has a history of incurring or paying a specific item of expense at the end of the taxable year, or after the end of the taxable year that is deemed incurred or paid during the taxable year, if, in each of the two taxable years immediately preceding the current taxable year (or the immediately preceding taxable year if the taxpayer was not in existence for the two preceding taxable years), the taxpayer incurred or paid the specific item of expense at the end of each taxable year, or after the end of each taxable year that was deemed incurred or paid during such taxable year. For purposes of §1.6655-2(f)(2)(i), the term "the end of the taxable year" means the period between and including the 15th and last day of the last month of the taxable year.

The proposed regulations also provide guidance regarding the treatment of specific items for purposes of computing annualized taxable income for an annualization period. For example, net operating loss carryovers must be taken into account in computing an annualized income installment after placing the taxable income for the annualization period on an annualized basis, and section 481(a) adjustments must be recognized ratably over the applicable adjustment period.

Revenue Ruling 67-93 (1967-1 C.B. 366), provides that a taxpayer should deduct a net operating loss (NOL) carryover from the income for an annualization period before annualizing the income for that period. As previously stated, the IRS and Treasury Department believe that it is not appropriate for taxpayers to determine taxable income for an annualization period or an adjusted seasonal installment period as though the period is a short taxable year. As a result, the IRS and Treasury Department now believe that it is a more appropriate reflection of annualized taxable income if a NOL carryover is deducted after annualizing the taxable income for an applicable annualization period or adjusted seasonal installment period. Accordingly, the proposed regulations provide that a taxpayer must annualize taxable income before taking into account a NOL carryover and reduce the annualized amount by the NOL carryover. As a result, Rev. Rul. 67-93 will be obsoleted when these

regulations are effective.

In addition, the proposed regulations provide guidance on the amount of depreciation and amortization (depreciation) expense that a taxpayer may take into account for an annualization period. The proposed regulations generally provide that a proportionate amount of a taxpayer's estimated annual depreciation expense shall be taken into account when determining any annualized income installment for the taxable year. In determining the estimated annual depreciation expense, a taxpayer may take into account purchases, sales or other dispositions, changes in use, depreciation permitted by sections 168(k) and 1400L, and other similar events that, based on all of the relevant information available as of the last day of the annualization period (such as capital spending budgets, financial statement data and projections, or similar reports that provide evidence of the taxpayer's capital spending plans for the current taxable year), the taxpayer reasonably expects to occur during the taxable year. As an alternative to estimating annual depreciation expense based on events that are reasonably expected to occur, the proposed regulations provide that, in general, a taxpayer may claim for an annualization period at least a proportionate amount of 50 percent of the taxpayer's estimated depreciation expense for the current taxable year attributable to assets that the taxpayer had in service on the last day of the preceding taxable year, that remain

in service on the first day of the current taxable year, and that are subject to the half-year convention. The proposed regulations also provide that an annualization period cannot be treated as a short taxable year, including for purposes of determining the depreciation allowance for such annualization period.

The proposed regulations also provide guidance regarding short taxable years, including the due dates for required installments for a short taxable year (including a taxpayer's initial taxable year), the computation of such installments, and the applicable percentage of the annual tax due with each installment.

Proposed Effective Date

These regulations are proposed to apply to taxable years beginning after the date that is 30 days after the date the final regulations are published in the **Federal Register**. Until the final regulations become effective, taxpayers may rely on these proposed rules for taxable years beginning on or after the date this notice of proposed rulemaking is published in the **Federal Register**, provided, however, that the taxpayer applies all of these proposed rules in determining its required installments.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. Except

with respect to §1.6655-5, which deals with the rules applicable to a short taxable year, it has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because these provisions do not impose a collection of information on small businesses, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. With respect to §1.6655-5, it is hereby certified that this provision of the regulations will not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that not many small businesses are going to be subject to the short taxable year rules because: (1) existing small businesses generally are not targets of mergers and acquisitions, which result in a short taxable year; (2) start-up small businesses with a short taxable year of less than four months do not have to pay estimated taxes; and (3) start-up small businesses with a short taxable year of four months or more are not likely to have taxable income that would be subject to the corporate estimated tax rules. Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Internal Revenue Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small businesses.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any electronic or written comments (a signed original and eight (8) copies) that are submitted timely to the IRS. The IRS and Treasury Department request comments on the clarity of the proposed rules and how they can be made easier to understand. In particular, the IRS and Treasury Department request comments on whether the 52-53 week taxable year rules under §1.6655-2(e) should be simplified. The IRS and Treasury Department also request comments on whether the final regulations should include an additional exception, similar to the exception provided in §1.6655-2(f)(2)(i), that would permit a taxpayer to take into account for an annualization period a proportionate amount of a specific item of expense that is attributable to income earned throughout the current taxable year and is paid or incurred during the taxable year but after the applicable annualization period. If such an exception is appropriate, the IRS and Treasury Department request comments on what specific types of expenses would meet the requirements of the rule, and whether the exception should provide for any additional limitations, such as a requirement that a minimum percentage of the annual amount of the expense be paid or incurred on a particular day

during the taxable year. All comments will be available for public inspection and copying.

A public hearing has been scheduled for February 22, 2006, beginning at 10:00 a.m. in the Auditorium of the Internal Revenue Service Building, 1111 Constitution Avenue, NW., Washington, DC. Due to building security procedures, visitors must enter at the Constitution Avenue entrance. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 30 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the "FOR FURTHER INFORMATION CONTACT" section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments must submit electronic or written comments and an outline of the topics to be discussed and time to be devoted to each topic (a signed original and eight (8) copies) by February 22, 2006. A period of 10 minutes will be allotted to each person for making comments. An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

The principal authors of these regulations are Robert A. Desilets, Jr., formerly of the Office of Associate Chief Counsel (Procedure and Administration), Administrative Provisions and Judicial Practice Division, and Joseph P. Dewald, Office of Associate Chief Counsel (Procedure and Administration), Administrative Provisions and Judicial Practice Division.

List of Subjects

26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

26 CFR Part 301

Employment taxes, Estate taxes, Excise taxes, Gift taxes, Income taxes, Penalties, Reporting and recordkeeping requirements.

Partial Withdrawal of a Previous Notice of Proposed Rulemaking

Accordingly, under the authority of 26 U.S.C. 7805, §§1.6152-1(a)(1), 1.6654-2(d)(1)(i), 1.6655-1, 1.6655-2, 1.6655-3, 1.6655-4, 1.6655-5, 1.6655-6, and 301.6655-1 in the notice of proposed rulemaking published in the **Federal Register** on March 26, 1984, (LR-228-82) (49 FR 11186) are withdrawn.

Proposed Amendments to the Regulations

Accordingly, 26 CFR parts 1 and 301 are proposed to be amended as follows:

PART 1--INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by

adding an entry in numerical order to read as follows:

Authority: 26 U.S.C. 7805 * * *

Section 1.6655-5 also issued under 26 U.S.C. 6655(i)(2). * * *

Par. 2. In §1.56-0, the heading for paragraph (e)(5) is added to read as follows:

§1.56-0 Table of contents to §1.56-1, adjustment for book income of corporations.

* * * * *

(e) * * *

(5) Effective date.

Par. 3. In §1.56-1, paragraph (e)(4) is revised and paragraph (e)(5) is added to read as follows:

§1.56-1 Adjustment for the book income of corporations.

* * * * *

(e) * * *

(4) Estimating the book income adjustment for purposes of the estimated tax liability. See §1.6655-7, as issued by TD 8307 (55 FR 33671), for special rules for estimating the corporate alternative minimum tax book income adjustment under the annualization exception.

(5) Effective date. Paragraph (e)(4) of this section is applicable for taxable years beginning after the date that is 30 days after the date the final regulations are published in the

Federal Register.

Par. 4. In §1.6425-2, paragraph (a) is revised and paragraph (c) is added to read as follows:

§1.6425-2 Computation of adjustment of overpayment of estimated tax.

(a) Income tax liability defined. For purposes of §§1.6425-1 through 1.6425-3 and 1.6655-7, relating to excessive adjustment, the term income tax liability means the excess of--

(1) The sum of--

(i) The tax imposed by section 11 or 1201(a), or subchapter L of chapter 1 of the Internal Revenue Code, whichever is applicable; plus

(ii) The tax imposed by section 55; over

(2) The credits against tax provided by part IV of subchapter A of chapter 1 of the Internal Revenue Code.

* * * * *

(c) Effective date. Paragraph (a) of this section is applicable to applications for adjustments of overpayments of estimated income tax that are filed in taxable years beginning after the date that is 30 days after the date the final regulations are published in the **Federal Register**.

Par. 5. Section 1.6425-3 is amended by:

1. Revising paragraphs (f)(1) and (f)(2).
2. Adding paragraph (f)(3).

The revisions and addition read as follows:

§1.6425-3 Allowance of adjustments.

* * * * *

(f) Effect of adjustment. (1) For purposes of all sections of the Internal Revenue Code except section 6655, relating to additions to tax for failure to pay estimated income tax, any adjustment under section 6425 is to be treated as a reduction of prior estimated tax payments as of the date the credit is allowed or the refund is paid. For the purpose of sections 6655(a) through (g), (i), and (j), credit or refund of an adjustment is to be treated as if not made in determining whether there has been any underpayment of estimated income tax and, if there is an underpayment, the period during which the underpayment existed. However, an excessive adjustment under section 6425 shall be taken into account in applying the addition to tax under section 6655(h).

(2) For the effect of an excessive adjustment under section 6425, see §1.6655-7.

(3) This paragraph (f) is applicable to applications for adjustments of overpayments of estimated income tax that are filed in taxable years beginning after the date that is 30 days after the date the final regulations are published in the **Federal Register**.

Par. 6. Section 1.6655-0 is added to read as follows:

§1.6655-0 Table of contents.

This section lists the table of contents for §§1.6655-1 through 1.6655-7.

§1.6655-1 Addition to the tax in the case of a corporation.

- (a) In general.
- (b) Amount of underpayment.
- (c) Period of the underpayment.
- (d) Amount of required installment.
- (e) Large corporation required to pay 100 percent of current year tax.
 - (1) In general.
 - (2) May use last year's tax for 1st installment.
- (f) Required installment due dates.
 - (1) Number of required installments.
 - (2) Time for payment of installments.
 - (i) Calendar year.
 - (ii) Fiscal year.
 - (iii) Short taxable year.
 - (iv) Partial month.
- (g) Definitions.
- (h) Special rules for consolidated returns.
- (i) Overpayments applied to subsequent taxable year's estimated tax.
 - (1) In general.
 - (2) Subsequent examinations.
- (j) Examples.
- (k) Effective date.

§1.6655-2 Annualized income installment method.

- (a) In general.
- (b) Determination of annualized income installment--In general.
- (c) Special rules.
 - (1) Applicable percentage.
 - (2) Partial month.
- (d) Election of different annualization periods.
- (e) 52-53 week taxable year.
- (f) Determination of taxable income for an annualization period.
 - (1) In general.
 - (2) Exceptions.
 - (i) Annual expenses paid or incurred at or after the end of the taxable year.
 - (ii) Net operating loss carryover.
 - (iii) Credit carryover.

- (iv) Section 481(a) adjustment.
- (v) Depreciation and amortization.
 - (A) General rule.
 - (B) Short taxable years.
- (vi) Member of partnership.
 - (3) Examples.
- (g) Items that substantially affect taxable income but cannot be determined accurately by the installment due date.
 - (1) In general.
 - (2) Example.
- (h) Events arising after installment due date that were not reasonably foreseeable.
 - (1) In general.
 - (2) Example.
- (i) Effective date.

§1.6655-3 Adjusted seasonal installment method.

- (a) In general.
- (b) Limitation on application of section.
- (c) Determination of amount.
- (d) Special rules.
 - (1) Base period percentage.
 - (2) Filing month.
 - (3) Application of the rules related to the annualized income installment method to the adjusted seasonal installment method.
- (e) Example.
- (f) Effective date.

§1.6655-4 Large corporations.

- (a) Large corporation defined.
- (b) Testing period.
- (c) Computation of taxable income during testing period.
 - (1) Short taxable year.
 - (2) Computation of taxable income in taxable year when there occurs a transaction to which section 381 applies.
- (d) Members of controlled group.
 - (1) In general.
 - (2) Aggregation.
 - (3) Allocation rule.
 - (4) Controlled group members.
- (e) Effect on a corporation's taxable income of items that may be carried back or carried over from any other taxable year.
- (f) Consolidated returns. [Reserved]

- (g) Example.
- (h) Effective date.

§1.6655-5 Short taxable year.

- (a) In general.
- (b) Exception to payment of estimated tax.
- (c) Installment due dates.
 - (1) In general.
 - (i) Taxable year of four months but less than twelve months.
 - (ii) Exception.
- (2) Early termination of taxable year.
 - (i) In general.
 - (ii) Exception.
- (d) Amount due for required installment.
 - (1) In general.
 - (2) Tax shown on the return for the preceding taxable year.
 - (3) Applicable percentage.
- (e) Examples.
- (f) 52 or 53 week taxable year.
- (g) Use of annualized income or seasonal installment method.
 - (1) In general.
 - (2) Computation of annualized income installment.
 - (3) Annualization period for final required installment.
 - (4) Examples.
- (h) Preceding taxable year a short taxable year.
- (i) Effective date.

§1.6655-6 Methods of accounting.

- (a) In general.
- (b) Exceptions.
 - (1) Automatic accounting method changes.
 - (2) Non-automatic accounting method changes.
- (c) Examples.
- (d) Effective date.

§1.6655-7 Addition to tax on account of excessive adjustment under section 6425.

Par. 7. Sections 1.6655-1, 1.6655-2, and 1.6655-3 are revised to read as follows:

§1.6655-1 Addition to the tax in the case of a corporation.

(a) In general. Section 6655 imposes an addition to the tax under chapter 1 of the Internal Revenue Code in the case of any underpayment of estimated tax by a corporation. An addition to tax due to the underpayment of estimated taxes is determined by applying the underpayment rate established under section 6621 to the amount of the underpayment, for the period of the underpayment. This addition to the tax is in addition to any applicable criminal penalties and is imposed whether or not there was reasonable cause for the underpayment.

(b) Amount of underpayment. The amount of the underpayment for any required installment is the excess of--

(1) The required installment; over

(2) The amount, if any, of the installment paid on or before the last date prescribed for such payment.

(c) Period of the underpayment. The period of the underpayment of any required installment runs from the date the installment was required to be paid to the 15th day of the 3rd month following the close of the taxable year, or to the date such underpayment is paid, whichever is earlier. For purposes of determining the period of the underpayment--

(1) The date prescribed for payment of any installment of estimated tax shall be determined without regard to any extension of time; and

(2) A payment of estimated tax will be credited against unpaid required installments in the order in which such installments are required to be paid.

(d) Amount of required installment. Except as otherwise provided in this section and §§1.6655-2 through 1.6655-7, the amount of any required installment is 25 percent of the lesser of--

(1) 100 percent of the tax shown on the return for the taxable year (or, if no return is filed, 100 percent of the tax for such year); or

(2) 100 percent of the tax shown on the return of the corporation for the preceding taxable year.

(3) Paragraph (d)(2) of this section shall not apply if the preceding taxable year was not a taxable year of 12 months or the corporation did not file a return for such preceding taxable year showing a liability for tax.

(e) Large corporation required to pay 100 percent of current year tax--(1) In general. Except as provided in paragraph (e)(2) of this section, paragraph (d)(2) of this section shall not apply in the case of a large corporation (as defined in §1.6655-4).

(2) May use last year's tax for first installment. Paragraph (e)(1) of this section shall not apply for purposes of determining the amount of the 1st required installment for any taxable year. Any reduction in such 1st installment by reason of the preceding

sentence shall be recaptured by increasing the amount of the next required installment determined under paragraph (d)(1) of this section by the amount of such reduction and, if the next required installment is reduced by use of the annualized income installment method under §1.6655-2 or the adjusted seasonal installment method under §1.6655-3, by increasing subsequent required installments determined under paragraph (d)(1) of this section to the extent that the reduction has not previously been recaptured.

(f) Required installment due dates--(1) Number of required installments. Unless otherwise provided, corporations must make 4 required installments for each taxable year.

(2) Time for payment of installments--(i) Calendar year. In the case of a calendar year taxpayer, the due dates of the required installments are as follows:

1st.....	April 15
2nd.....	June 15
3rd.....	September 15
4th.....	December 15

(ii) Fiscal year. In the case of a taxpayer other than a calendar year taxpayer, the due dates of the required installments are as follows:

1st.....	15th day of 4 th month of the taxable year
2nd.....	15th day of 6 th month of the taxable year

3rd.....15th day of 9th month of the taxable year

4th.....15th day of 12th month of the taxable year

(iii) Short taxable year. See §1.6655-5 for rules regarding required installments for corporations with a short taxable year.

(iv) Partial month. Except as otherwise provided, for purposes of determining the due date of any required installment a partial month shall be treated as a full month.

(g) Definitions. (1) The term tax as used in this section and §§1.6655-2 through 1.6655-7 means the excess of--

(i) The sum of--

(A) The tax imposed by section 11, section 1201(a), or subchapter L of chapter 1 of the Internal Revenue Code, whichever is applicable;

(B) The tax imposed by section 55; plus

(C) The tax imposed by section 887; over

(D) The credits against tax provided by part IV of subchapter A of chapter 1 of the Internal Revenue Code.

(ii) In the case of a foreign corporation subject to taxation under section 11, section 1201(a), or subchapter L of chapter 1 of the Internal Revenue Code, the tax imposed by section 881 shall be treated as a tax imposed by section 11.

(iii) In the case of a partnership that is treated, pursuant to regulations issued under section 1446(f)(2), as a corporation for

purposes of this section, the tax imposed by section 1446 shall be treated as a tax imposed by section 11.

(2) For the purposes of paragraph (d)(2) of this section, the term return for the preceding taxable year means the Federal income tax return for such taxable year that is required by section 6012(a)(2). However, if an amended Federal income tax return has been filed before the due date for an installment, then the term return for the preceding taxable year means the Federal income tax return as amended. Paragraph (d)(2) of this section will apply without regard to whether the taxpayer's Federal income tax return for the preceding taxable year is filed in a timely manner.

(3) If the tax rates for the current taxable year for which estimated tax is being determined differ from the rates applicable to the preceding taxable year, the tax determined for the preceding taxable year shall be recomputed using the rates applicable to the current taxable year.

(h) Special rules for consolidated returns. For special rules relating to the determination of the amount of the underpayment in the case of a corporation whose income is included in a consolidated return, see §1.1502-5(b).

(i) Overpayments applied to subsequent taxable year's estimated tax--(1) In general. If a taxpayer elects under the provisions of sections 6402(b) and 6513(d) and the regulations to apply an

overpayment in year one against the estimated tax liability for year two, the overpayment will be applied to the required installment payments for year two in the order due and to the extent necessary to satisfy such installments, similar to the manner in which an actual overpayment of one installment is carried forward to the next installment. No interest is accrued or paid on an overpayment if the election to apply the overpayment against estimated tax is made.

(2) Subsequent examinations. If a deficiency is determined in an examination of a return for a taxable year that originally reflected an overpayment that was applied against estimated tax for the succeeding taxable year, interest on the deficiency will not begin to accrue on an amount applied until that amount is used to satisfy a required estimated tax payment in such taxable year. Regardless of whether the taxpayer anticipated the application of such overpayment from the prior taxable year in calculating and paying its required estimated tax installment liabilities for the current taxable year, the subsequently determined underpayment and interest computation thereon will not change the taxpayer's original election to apply the overpayment against the estimated tax liability of the succeeding taxable year. Any changes to the usage of the original overpayment from the prior taxable year are hypothetical only and solely for the purpose of computing deficiency interest. Overpayment interest will not be impacted. For further

guidance, see Rev. Rul. 99-40 (1999-2 C.B. 441), (see §601.601(d)(2)(ii)(b) of this chapter).

(j) Examples. The method prescribed in paragraphs (d) through (g) of this section may be illustrated by the following examples:

Example 1. X, a calendar year corporation, estimates its tax liability for its taxable year ending December 31, 2006, will be \$85,000. X is not a large corporation as defined in section 6655(g)(2) and §1.6655-4. X reported a liability of \$74,900 on its return for the taxable year ended December 31, 2005, with no credits against tax. X paid four installments of estimated tax, each in the amount of \$18,725 (25 percent of \$74,900), on April 17, 2006, June 15, 2006, September 15, 2006, and December 15, 2006, respectively. X reported a tax liability of \$88,900 on its return due March 15, 2007. X had a \$5,000 credit against tax for tax year 2006 as provided by part IV of subchapter A of chapter 1 of the Internal Revenue Code. X did not underpay its estimated tax for tax year 2006 for any of the four installments, determined as follows:

(i) Tax as defined in paragraph (g) of this section for 2006 (\$88,900-\$5,000)	\$83,900
(ii) Tax as defined in paragraph (g) of this section for 2005	74,900
(iii) 100% of the lesser of this paragraph (j), <u>Example 1</u> (i) or (ii)	74,900
(iv) Amount of estimated tax required to be paid on or before each installment date (25% of \$74,900)	18,725
(v) Deduct amount paid on or before each installment date	18,725
(vi) Amount of underpayment for each installment date	0

Example 2. (i) Facts. Y, a calendar year corporation, estimates its tax liability for its taxable year ending December 31, 2006, will be \$70,000. Y is not a large corporation as defined in

section 6655(g)(2) and §1.6655-4. Y reported a Federal income tax liability of \$90,000 for its taxable year ending December 31, 2005. Y paid no installment of estimated tax on or before April 17, 2006, June 15, 2006, or September 15, 2006, but made a payment of \$63,000 on December 15, 2006. On March 15, 2007, Y filed its income tax return showing a tax of \$70,000. Y had no credits against tax for tax year 2006. Of the \$63,000 paid by Y on December 15, 2006, \$17,500 is applied to each of the first three installments due on April 15, June 15, and September 15, 2006, and the remaining \$10,500 is applied to the fourth installment. Y has an underpayment of estimated tax for each of the first three installments of \$17,500 and for the fourth installment of \$7,000. The addition to tax under section 6655(a) is computed as follows:

(A) Tax as defined in paragraph (g) of this section for 2006	\$70,000
(B) Tax as defined in paragraph (g) of this section for 2005	90,000
(C) 100% of the lesser of this paragraph (j), <u>Example 2</u> (i)(A) or (i)(B)	70,000
(D) Amount of estimated tax required to be paid on or before each installment date (25% of \$70,000)	17,500
(E) Amount paid on or before the first, second, and third installment dates	0
(F) Amount paid on or before the fourth installment date	63,000
(G) Amount of underpayment for the first, second, and third installment dates	17,500
(H) Amount of underpayment for the fourth installment date	7,000

(ii) Addition to tax. Assuming that neither the annualized income installment method nor the adjusted seasonal installment method described in §§1.6655-2 and 1.6655-3 would result in a lower payment for any installment period, and the addition to tax is computed under section 6621(a)(2) at the rate of 8 percent per annum for the applicable periods of underpayment, the addition to tax is determined as follows:

(A) First installment (underpayment period 4-16-06 through 12-15-06), computed as $244/365 \times \$17,500 \times 8\%$	\$936
(B) Second installment (underpayment period 6-16-06 through 12-15-06), computed as $183/365 \times \$17,500 \times 8\%$	702
(C) Third installment (underpayment period 9-16-06 through 12-15-06), computed as $91/365 \times \$17,500 \times 8\%$	349
(D) Fourth installment (underpayment period 12-16-06 through 3-15-07), computed as $90/365 \times \$7,000 \times 8\%$	138
(E) Total of this paragraph (j), <u>Example 2</u> (ii)(A) through (D)	2,125

(k) Effective date. This section applies to taxable years beginning after the date that is 30 days after the date the final regulations are published in the **Federal Register**.

§1.6655-2 Annualized income installment method.

(a) In general. In the case of any required installment, if the corporation establishes that the annualized income installment determined under this section, or the adjusted seasonal installment determined under §1.6655-3, is less than the amount determined under §1.6655-1--

(1) The amount of such required installment shall be the annualized income installment (or, if less, the adjusted seasonal installment); and

(2) Any reduction in a required installment resulting from the application of this section will be recaptured by increasing the amount of the next required installment determined under §1.6655-1

by the amount of such reduction (and, if the next required installment is similarly reduced, by increasing subsequent required installments to the extent that the reduction has not previously been recaptured).

(b) Determination of annualized income installment--In general. In the case of any required installment, the annualized income installment is the excess (if any) of--

(1) The product of the applicable percentage and the tax for the taxable year computed by annualizing the taxable income and alternative minimum taxable income--

(i) For the first 3 months of the taxable year, in the case of the first required installment;

(ii) For the first 3 months of the taxable year, in the case of the second required installment;

(iii) For the first 6 months of the taxable year in the case of the third required installment; and

(iv) For the first 9 months of the taxable year, in the case of the fourth required installment; over

(2) The aggregate amount of any prior required installments for the taxable year.

(c) Special rules--(1) Applicable percentage. Except as otherwise provided in §1.6655-5(d) with respect to short taxable years--

In the case of the following required installments:	The applicable percentage is:
--	----------------------------------

1st.....	25
2nd.....	50
3rd.....	75
4th.....	100

(2) Partial month. Except as otherwise provided, for purposes of paragraph (b) of this section a partial month shall be treated as a month.

(d) Election of different annualization periods. (1) If the taxpayer timely files Form 8842, "Election to Use Different Annualization Periods for Corporate Estimated Tax," in accordance with section 6655(e)(2)(C)(iii), and elects Option 1--

(i) Paragraph (b)(1)(i) of this section will be applied by using the language "2 months" instead of "3 months";

(ii) Paragraph (b)(1)(ii) of this section will be applied by using the language "4 months" instead of "3 months";

(iii) Paragraph (b)(1)(iii) of this section will be applied by using the language "7 months" instead of "6 months"; and

(iv) Paragraph (b)(1)(iv) of this section will be applied by using the language "10 months" instead of "9 months".

(2) If the taxpayer timely files Form 8842, in accordance with section 6655(e)(2)(C)(iii), and elects Option 2--

(i) Paragraph (b)(1)(ii) of this section will be applied by using the language "5 months" instead of "3 months";

(ii) Paragraph (b)(1)(iii) of this section will be applied by using the language "8 months" instead of "6 months"; and

(iii) Paragraph (b)(1)(iv) of this section will be applied by using the language "11 months" instead of "9 months".

(e) 52-53 week taxable year. (1) Generally, in the case of a taxpayer whose taxable year constitutes 52 or 53 weeks in accordance with section 441(f), the rules prescribed by §1.441-2 shall be applicable in determining--

(i) Whether a taxable year is a taxable year of 12 months; and

(ii) When the 2-, 3-, 4-, 5-, 6-, 7-, 8-, 9-, 10-, or 11-month period (whichever is applicable) commences and ends for purposes of paragraphs (b)(1), (d)(1) and (d)(2) of this section.

(2) If a taxpayer employs four 13-week periods or thirteen 4-week accounting periods and the end of any accounting period employed by the taxpayer does not correspond to the end of the 2-, 3-, 4-, 5-, 6-, 7-, 8-, 9-, 10-, or 11-month period (whichever is applicable), then, provided the taxpayer has at least one full 4-week or 13-week accounting period, as appropriate, within the applicable period, annualized taxable income for the applicable period shall be--

(i) $[(x/(y*13))*z]$, in the case of a taxpayer using four 13-

week periods, if--

(A) x = Taxable income for the number of full 13-week periods in the applicable period;

(B) y = The number of full 13-week periods in the applicable period; and

(C) z = The number of weeks in the taxable year; or

(ii) $[(x/(y*4))*z]$, in the case of a taxpayer using thirteen 4-week periods, if--

(A) x = Taxable income for the full 4-week periods in the applicable period;

(B) y = The number of full 4-week periods in the applicable period; and

(C) z = The number of weeks in the taxable year.

(3) If a taxpayer employs four 13-week periods and the taxpayer does not have at least one 13-week period within the applicable 2-, 3-, 4-, 5-, 6-, 7-, 8-, 9-, 10-, or 11-month period, the taxpayer shall be permitted to determine annualized taxable income for the applicable period based upon--

(i) The taxable income for the number of weeks in the applicable period; or

(ii) The taxable income for the full 13-week periods that end before the due date of the required installment.

(4) The following examples illustrate the rules of

this paragraph (e):

Example 1. Taxpayer A, an accrual method taxpayer, uses a 52/53 week year-end ending on the last Friday in December and uses four thirteen-week periods. For its year beginning December 30, 2006, A uses the annualized income installment method under section 6655(e)(2)(A)(i) to calculate all of its required installments. For purposes of computing its first and second required installments, the first 3 months of A's taxable year under paragraph (b)(1)(i) of this section will end on March 30th, the thirteenth Friday of A's taxable year. For purposes of its third required installment, the first 6 months of A's taxable year will end on June 29th, the twenty-sixth Friday of A's taxable year. For purposes of its fourth required installment, the first 9 months of A's taxable year will end on September 28th, the thirty-ninth Friday of A's taxable year.

Example 2. Same facts as Example 1 except that A uses thirteen four-week periods and there are 52 weeks during A's taxable year beginning December 30, 2006, and ending December 28, 2007. For purposes of computing A's first and second required installments, A's annualized taxable income for the first three months will be the taxable income for the first three four-week periods of A's taxable year (December 30, 2006, through March 23, 2007) divided by 12 (number of full four-week periods in the first three months (3) multiplied by 4) and multiplied by 52 (the number of weeks in the taxable year). For purposes of computing A's third required installment, A's annualized taxable income for the first six months will be the taxable income for the first six four-week periods of A's taxable year (December 30, 2006, through June 15, 2007) divided by 24 and multiplied by 52. For purposes of computing A's fourth required installment, A's annualized taxable income for the first nine months will be the taxable income for the first nine four-week periods of A's taxable year (December 30, 2006, through September 7, 2007) divided by 36 and multiplied by 52.

(5) The application of the annualized income installment

method is illustrated by the following example:

Example. (i) X, a calendar year corporation, had a taxable year of less than twelve months for tax year 2005 and no credits against tax for tax year 2006. X made an estimated tax payment of \$15,000 on the installment dates of April 17, 2006, June 15, 2006, September 15, 2006, and December 15, 2006, respectively. Assume

that, under paragraph (d)(1) of this section, X elected Option 1 by timely filing Form 8842, in accordance with section 6655(e)(2)(C)(iii), and determined that its taxable income for the first 2, 4, 7 and 10 months was \$25,000, \$64,000, \$125,000, and \$175,000 respectively. The income for each period is annualized as follows:

$$\$25,000 \times 12/2 = \$150,000$$

$$\$64,000 \times 12/4 = \$192,000$$

$$\$125,000 \times 12/7 = \$214,286$$

$$\$175,000 \times 12/10 = \$210,000$$

(ii)(A) To determine whether the installment payment made on April 17, 2006, equals or exceeds the amount that would have been required to have been paid if the estimated tax were equal to 100 percent of the tax computed on the annualized income for the 2-month period, the following computation is necessary:

(1) Annualized income for the 2 month period	\$150,000
(2) Tax on this paragraph (e)(5), <u>Example</u> (ii)(A)(1)	41,750
(3) 100% of this paragraph (e)(5), <u>Example</u> (ii)(A)(2)	41,750
(4) 25% of this paragraph (e)(5), <u>Example</u> (ii)(A)(3)	10,438

(B) Because the total amount of estimated tax that was timely paid on or before the first installment date (\$15,000) exceeds the amount required to be paid on or before this date if the estimated tax were 100 percent of the tax determined by placing on an annualized basis the taxable income for the first 2-month period, the exception described in paragraphs (a) and (b) of this section applies, and no addition to tax will be imposed for the installment due on April 15, 2006.

(iii)(A) To determine whether the installment payments made on or before June 15, 2006, equal or exceed the amount that would have been required to have been paid if the estimated tax were equal to 100 percent of the tax computed on the annualized income for the 4-

month period, the following computation is necessary:

(1) Annualized income for the 4 month period	\$192,000
(2) Tax on this paragraph (e)(5), <u>Example</u> (iii)(A)(1)	58,130
(3) 100% of this paragraph (e)(5), <u>Example</u> (iii)(A)(2)	58,130
(4) 50% of this paragraph (e)(5), <u>Example</u> (iii)(A)(3) less \$10,438 (amount due with the first installment)	18,627

(B) Because the total amount of estimated tax actually paid on or before the second installment date (\$19,562 (\$15,000 second required installment payment plus \$4,562 overpayment of first required installment)) exceeds the amount required to be paid on or before this date if the estimated tax were 100 percent of the tax determined by placing on an annualized basis the taxable income for the first 4-month period, the exception described in paragraphs (a) and (b) of this section applies, and no addition to tax will be imposed for the installment due on June 15, 2006.

(iv)(A) To determine whether the installment payments made on or before September 15, 2006, equal or exceed the amount that would have been required to have been paid if the estimated tax were equal to 100 percent of the tax computed on the annualized income for the 7-month period, the following computation is necessary:

(1) Annualized income for the 7 month period	\$214,286
(2) Tax on this paragraph (e)(5), <u>Example</u> (iv)(A)(1)	66,821
(3) 100% of this paragraph (e)(5), <u>Example</u> (iv)(A)(2)	66,821
(4) 75% of this paragraph (e)(5), <u>Example</u> (iv)(A)(3) less \$29,065 (amount due with the first and second installment)	21,051

(B) Because the total amount of estimated tax actually paid on or before the third installment date (\$15,935 (\$15,000 third required installment payment plus \$935 overpayment of second

required installment)) does not equal or exceed the amount required to be paid on or before this date if the estimated tax were 100 percent of the tax determined by placing on an annualized basis the taxable income for the first 7-month period, the exception described in paragraphs (a) and (b) of this section does not apply, and an addition to tax will be imposed with respect to the underpayment of the September 15, 2006, installment unless another exception applies to this installment payment.

(v)(A) To determine whether the installment payments made on or before December 15, 2006, equal or exceed the amount that would have been required to have been paid if the estimated tax were equal to 100 percent of the tax computed on the annualized income for the 10-month period, the following computation is necessary:

(1) Annualized income for the 10 month period	\$210,000
(2) Tax on this paragraph (e)(5), <u>Example</u> (v)(A)(1)	65,150
(3) 100% of this paragraph (e)(5), <u>Example</u> (v)(A)(2)	65,150
(4) 100% of this paragraph (e)(5), <u>Example</u> (v)(A)(3) less \$50,116 (amount due with the first, second, and third installment)	15,034

(B) Because the total amount of estimated tax payments made on or before the fourth installment date that is available to be applied to the estimated tax due for the fourth installment (\$9,884 (\$15,000 fourth required installment payment less \$5,116 underpayment for the third installment of estimated tax (\$21,051 third installment of estimated tax due less \$15,935 payments available to be applied to the third installment of estimated tax))) does not equal or exceed the amount required to be paid on or before this date if the estimated tax were 100 percent of the tax determined by placing on an annualized basis the taxable income for the first 10-month period, the exception described in paragraphs (a) and (b) of this section does not apply, and an addition to tax will be imposed with respect to the underpayment of the December 15, 2006, installment unless another exception applies to this installment payment.

(vi) Assuming that no other exceptions apply and the addition to tax is computed under section 6621(a)(2) at the rate of 8 percent

per annum for the applicable periods of underpayment, the amount of the addition to tax is as follows:

(A) First installment (no underpayment)	
(B) Second installment (no underpayment)	
(C) Third installment (underpayment period 9-16-06 through 12-15-06), computed as $91/365 \times \$5,116 \times 8\%$	102
(D) Fourth installment (underpayment period 12-16-06 through 3-15-07), computed as $90/365 \times \$5,150 \times 8\%$	102
(E) Total of this paragraph (e)(5), <u>Example</u> (vi)(A) through (D)	204

(f) Determination of taxable income for an annualization period--(1) In general. In determining the applicability of the exception described in paragraphs (a) and (b) of this section (relating to the annualization of income) and the exception described in §1.6655-3 (relating to annualization of income for corporations with seasonal income), and for purposes of computing a taxpayer's taxable income (and applicable tax), an item must be taken into account in computing a taxpayer's taxable income for the taxable year for which the estimated tax is being determined, and must be properly taken into account in determining a taxpayer's taxable income (and applicable tax) for the applicable annualization period by the last day of the such period. Generally, except as provided in paragraph (f)(2) of this section, for an item to be taken into account during an annualization period, the following must occur on or before the last day of the applicable annualization

period (determined based on the accounting period employed by the taxpayer):

(i) With respect to an item of gross income, such income is includible in computing taxable income in accordance with section 451 or the appropriate provision of the Internal Revenue Code (for example, section 453 for installment sales or section 460 for long-term contracts).

(ii) With respect to an item of loss, the loss must be permitted to be taken into account under the appropriate provision of the Internal Revenue Code.

(iii) With respect to an item of deduction, for taxpayers using the cash receipts and disbursements method of accounting, the deduction must be paid under §1.461-1(a)(1) and otherwise deductible in computing taxable income for the annualization period or, for taxpayers using an accrual method of accounting, the deduction must be incurred under §1.461-1(a)(2) and otherwise deductible in computing taxable income for the annualization period. In the case of an accrual method taxpayer, the provisions of section 170(a)(2) and §1.170A-11(b) (charitable contributions by accrual method corporations), §1.461-4(d)(6)(ii) (provision of services or property to a taxpayer), §1.461-5 (recurring item exception), and any other provision that has a similar effect can not be used in determining whether the item of deduction has been incurred under §1.461-1(a)(2)

and is otherwise deductible for purposes of computing taxable income for an annualization period. For purposes of section 404 and the regulations, regardless of the overall method of accounting employed by the taxpayer, the applicable 2-, 3-, 4-, 5-, 6-, 7-, 8-, 9-, 10- or 11-month period shall not be treated as a short taxable year and the rules of section 404 and the regulations shall be applied on the basis of the taxpayer's taxable year for which estimated tax is being determined. Thus, the determination of whether a payment to an employee is deferred compensation under §1.404(b)-1T shall be made by reference to whether the payment is received by the employee more than a brief period of time after the last day of the taxable year for which estimated tax is being determined and not the last day of the applicable annualization period. With respect to contributions to qualified plans governed by section 404 and the regulations, in determining whether an item is paid or incurred by the end of an annualization period, economic performance is satisfied only to the extent such item is paid by the last day of the applicable annualization period (without regard to section 404(a)(6)) and does not, in combination with other such items paid during the applicable annualization period, exceed the applicable deduction limit of section 404(a) for the taxable year. For purposes of sections 419 and 419A and the regulations, regardless of the overall method of accounting employed by the taxpayer, the

applicable 2-, 3-, 4-, 5-, 6-, 7-, 8-, 9-, 10-, or 11-month period shall not be treated as a short taxable year and the rules of sections 419 and 419A and the regulations shall be applied on the basis of the taxpayer's taxable year for which estimated tax is being determined. With respect to contributions to a welfare benefit fund governed by sections 419 and 419A and the regulations, in determining whether an item is paid or incurred by the end of an annualization period, economic performance is satisfied only to the extent such item is paid by the last day of the applicable annualization period and does not, in combination with other such items paid during such annualization period, exceed the applicable deduction limit of section 419 for the taxable year.

(iv) With respect to depreciation and amortization (depreciation) expense, a taxpayer shall take into account depreciation expense only as provided in paragraph (f)(2)(v) of this section.

(v) With respect to any item taken into account in computing taxable income for the annualization period that is not described in paragraphs (f)(1)(i), (ii), (iii), and (iv) of this section, the item is includible in computing taxable income in accordance with the appropriate provision of the Internal Revenue Code.

(vi) With respect to an item of credit, the amounts upon which the credit is computed must have been taken into account in

computing taxable income for the annualization period pursuant to paragraphs (f)(1)(i), (ii), (iii), (iv), and (v) of this section, as applicable.

(2) Exceptions--(i) Annual expenses paid or incurred at or after the end of the taxable year. (A) Except as otherwise provided in paragraphs (f)(2)(ii) through (vi) of this section, if an accrual method taxpayer has a history of incurring a specific item of expense under §1.461-1(a)(2) (or a cash method taxpayer has a history of paying a specific item of expense under §1.461-1(a)(1)) that, while attributable to income earned throughout the current taxable year, is not incurred (or paid, in the case of a cash method taxpayer) until the end of the taxable year, or after the end of the current taxable year and is deemed incurred (or paid, in the case of a cash method taxpayer) during the current taxable year (taking into account, as applicable, section 170(a)(2) and §1.170A-11(b), section 404(a)(6), §1.461-4(d)(6)(ii), §1.461-5, and any other provision that has a similar effect), then the taxpayer may, in lieu of any amount determined under paragraph (f)(1) of this section, take into account for the applicable annualization period the amount of such expense properly allocable to such period provided the amount so allocated to such annualization period is determinable with reasonable accuracy and the amount of the item so allocated is properly deducted by the taxpayer during the current taxable year

under the taxpayer's method of accounting.

(B) For purposes of this paragraph (f)(2)(i), the portion of an annual expense item allocable to an annualization period will be considered to be determined with reasonable accuracy if such item is allocated evenly throughout the taxable year unless the taxpayer is able to clearly demonstrate such item is more appropriately allocable to an annualization period by some other method including, for example, in proportion to the earning of revenue, the use of property, or the provision of services. For purposes of this paragraph (f)(2)(i), a taxpayer has a history of incurring or paying a specific item of expense at the end of the taxable year, or after the end of the taxable year that is deemed incurred or paid during the taxable year, if, in each of the two taxable years immediately preceding the current taxable year (or the immediately preceding taxable year if the taxpayer was not in existence for the two preceding taxable years), the taxpayer incurred or paid the specific item of expense at the end of each taxable year, or after the end of each taxable year that was deemed incurred or paid during such taxable year. In addition, for purposes of this paragraph (f)(2)(i), the term "the end of the taxable year" means the period between and including the 15th and last day of the last month of the taxable year.

(ii) Net operating loss carryover. Any net operating loss

carryover to the current taxable year shall be taken into account in computing an annualized income installment only after annualizing the taxable income for the annualization period.

(iii) Credit carryover. Any credit carryover to the current taxable year shall be taken into account in computing an annualized income installment only after annualizing the taxable income for the annualization period and computing the applicable tax, and before applying the applicable percentage.

(iv) Section 481(a) adjustment. (A) Any section 481(a) adjustment required to be recognized during the taxable year shall be recognized ratably over the number of months in the taxable year.

(B) With respect to a Form 3115, "Application for Change in Accounting Method," filed during the current taxable year or a preceding taxable year, if the change in method of accounting--

(1) Is permitted to be made with the automatic consent of the Commissioner, the appropriate portion of the section 481(a) adjustment determined under paragraph (f)(2)(iv)(A) of this section shall be taken into account in determining an annualized income installment if, and only if, the copy of the Form 3115 has been mailed to the IRS National Office on or before the last day of the annualization period; or

(2) Requires the prior consent of the Commissioner, the appropriate portion of the section 481(a) adjustment determined

under paragraph (f)(2)(iv)(A) of this section shall be taken into account in determining an annualized income installment if, and only if, the consent agreement reflecting the Commissioner's consent to the change in method of accounting and the prescribed terms and conditions for effecting such change has been signed by the taxpayer and mailed to the IRS National Office on or before the last day of the annualization period.

(v) Depreciation and amortization--(A) General rule. In determining any annualized income installment, a proportionate amount of the taxpayer's estimated annual depreciation and amortization (depreciation) expense shall be taken into account. For purposes of the preceding sentence, estimated annual depreciation expense is the estimated depreciation expense to be properly taken into account in determining the taxpayer's taxable income for the taxable year. In determining the estimated annual depreciation expense, a taxpayer may take into account purchases, sales or other dispositions, changes in use, depreciation deductions permitted under sections 168(k) and 1400L(b), and other similar events and provisions (for example, section 179) that, based on all the relevant information available as of the last day of the annualization period (such as capital spending budgets, financial statement data and projections, or similar reports that provide evidence of the taxpayer's capital spending plans for the current

taxable year), are reasonably expected to occur or apply during the taxable year. For purposes of the additional first-year depreciation deduction under sections 168(k) and 1400L(b), only a proportionate amount of the current year's additional first-year depreciation deduction to be taken into account in determining a taxpayer's taxable income for the taxable year is taken into account in computing taxable income for an annualization period. As an alternative to estimating annual depreciation expense based on events that are reasonably expected to occur, a taxpayer may claim for an annualization period at least a proportionate amount of 50 percent of the taxpayer's estimated depreciation expense for the current taxable year attributable to assets that a taxpayer had in service on the last day of the preceding taxable year, that remain in service on the first day of the current taxable year, and that are subject to the half-year convention.

(B) Short taxable years. Unless the taxable year is, or will be, a short taxable year, in no circumstance may an annualization period be treated as a short taxable year for purposes of determining the depreciation allowance for such annualization period. If the taxable year is, or will be (based on all relevant information available as of the last day of the annualization period), a short taxable year, annual depreciation expense shall be computed using the rules applicable for computing depreciation

during a short taxable year for purposes of determining the annual depreciation expense to be allocated to an annualization period. For this purpose, the rules applicable for computing depreciation during a short taxable year shall be applied on the basis of the date the taxable year is expected to end based on all relevant information available as of the last day of the annualization period. See Rev. Proc. 89-15 (1989-1 C.B. 816), (see §601.601(d)(2)(ii)(b) of this chapter).

(vi) Member of partnership. In determining a partner's distributive share of partnership items that must be taken into account during an annualization period, the rules set forth in §1.6654-2(d)(2) are applicable.

(3) Examples. The provisions of this paragraph (f) are illustrated by the following examples:

Example 1. Corporation A, a calendar year taxpayer, uses an accrual method of accounting and uses the annualized income installment method under section 6655(e)(2)(A)(i) to calculate its first required installment payment for its 2006 taxable year. Consistent with its historical practice, the board of directors of A, on or before March 31, 2006, make a binding, irrevocable commitment to fund a minimum contribution of \$10,000,000 to A's qualified retirement plan by March 15, 2007, which fixes A's liability to make the \$10,000,000 contribution. Similarly, consistent with A's historical practice, A plans to remit payments to the retirement plan of \$1,000,000 on January 2, 2007, and \$9,000,000 on March 1, 2007. The \$10,000,000 commitment is not taken into account for purposes of determining A's first annualized income installment, which is based on the income and deductions from the first three months of the taxable year, because A did not make any payments by March 31, 2006 (and therefore did not satisfy the economic performance requirements of §1.461-4(d)(2)(iii) by March

31, 2006), in accordance with paragraph (f)(1)(iii) of this section. The \$10,000,000 is not treated as paid on or before March 31, 2006, under section 404(a)(6) because, pursuant to paragraph (f)(1)(iii) of this section, the last day of the annualization period is not to be treated as the last day of A's taxable year. However, pursuant to paragraph (f)(2)(i)(A) of this section, because A has historically incurred a retirement plan expense during the taxable year pursuant to section 404 that, but for the deeming rule of section 404(a)(6), would have been incurred after the end of the taxable year, and because A satisfies the other requirements of paragraph (f)(2)(i)(A) of this section, A may take into account a \$2,500,000 retirement plan expense for purposes of determining A's taxable income to be annualized in computing A's first annualized income installment for 2006 ($\$10,000,000/12 \times 3 = \$2,500,000$) unless, pursuant to paragraph (f)(2)(i)(B) of this section, A is able to clearly demonstrate that the retirement plan expense is more appropriately allocable by some other method.

Example 2. Same facts as Example 1 except that, consistent with its historical practice, A remits \$9,000,000 to the retirement plan on June 30, 2006, and \$1,000,000 to the retirement plan on September 30, 2006. For purposes of determining A's first and second required installments for 2006, which are based on the income and deductions from the first three months of the taxable year, A may not take into account any of the retirement plan expense because A did not make any payments by March 31, 2006 (and therefore did not satisfy the economic performance requirements of §1.461-4(d)(2)(iii) by March 31, 2006), in accordance with paragraph (f)(1)(iii) of this section. For A's third required installment, which is based on the income and deductions from the first six months of the taxable year, A may take into account a \$9,000,000 retirement plan expense for purposes of determining A's annualized taxable income because A incurred the \$9,000,000 expense by June 30, 2006. For A's fourth required installment, which is based on the income and deductions from the first nine months of the taxable year, A may take into account a \$10,000,000 retirement plan expense for purposes of determining A's annualized taxable income because A incurred the \$10,000,000 retirement plan expense by September 30, 2006.

Example 3. Corporation B, a calendar year taxpayer, uses an accrual method of accounting and the annualized income installment method under section 6655(e)(2)(A)(i) to calculate its first required installment. In each of the three preceding taxable years, B has paid annual bonuses on the Friday immediately preceding December 25 to those employees of B that provided services to B

during the taxable year and were employed by B on the date such bonuses were paid. At the beginning of 2006, consistent with its historical experience, B's board of directors pass a resolution that B will pay cash bonuses of \$6,000,000 to those employees that have provided services to B during 2006 and are employed by B on December 22, 2006, the Friday immediately preceding December 25, 2006. B plans to pay, and does pay, the cash bonuses to eligible employees on March 1, 2007. The bonuses, pursuant to paragraph (f)(1)(iii) of this section, are not treated as deferred compensation for the taxable year or the annualization period under §1.404(b)-1T because the last day of the annualization period is not to be treated as the last day of B's taxable year. Because the bonuses are not treated as deferred compensation, the bonuses are not subject to section 404, and instead are treated as service liabilities under §1.461-4(d)(2)(i) rather than employee benefit liabilities under §1.461-4(d)(2)(iii). Thus, the bonuses are incurred when all the events have occurred that establish the fact of the liability, the amount of the liability can be determined with reasonable accuracy, and the services are provided to B by B's employees. If B's first required installment is made under the provisions of section 6655(e)(1), the \$6,000,000 is not taken into account for purposes of determining B's first annualized income installment, which is based on the income and deductions from the first three months of the taxable year, because B did not incur any liability for bonus payments for the current taxable year by March 31, 2006, in accordance with paragraph (f)(1)(iii) of this section. However, pursuant to paragraph (f)(2)(i)(A) of this section, because B has historically incurred a bonus expense at the end of the taxable year, and because B satisfies the other requirements of paragraph (f)(2)(i)(A) of this section, B may take into account a \$1,500,000 bonus expense for purposes of determining B's taxable income to be annualized in computing B's first annualized income installment for 2006 ($\$6,000,000/12 \times 3 = \$1,500,000$) unless, pursuant to paragraph (f)(2)(i)(B) of this section, B is able to clearly demonstrate that the bonus expense is more appropriately allocable by some other method.

Example 4. Corporation C, a calendar year taxpayer, uses an accrual method of accounting and the annualized income installment method under section 6655(e)(2)(A)(i) to calculate its first required installment for its 2006 taxable year. C has a net operating loss carryover to 2006 of \$400,000. C's taxable income from January 1, 2006, through March 31, 2006, without regard to any net operating loss carryover, is \$500,000. For purposes of determining C's first annualized income installment, C's annualized

taxable income is \$1,600,000, determined by placing C's first three months of taxable income from January 1, 2006, through March 31, 2006, on an annualized basis ($\$500,000 \times 12/3 = \$2,000,000$) and reducing the resulting amount of \$2,000,000 by the \$400,000 net operating loss carryover to 2006.

Example 5. Corporation D, a calendar year taxpayer, uses an accrual method of accounting and the annualized income installment method under section 6655(e)(2)(A)(i) to calculate all of its required installment payments for its 2006 taxable year. On April 15, 2005, D filed a Form 3115, "Application for Change in Accounting Method," to request the consent of the Commissioner to change its method of accounting for recognizing revenue. The Commissioner consented to D's requested change, and D signed and mailed the consent letter to the IRS National Office on December 15, 2005. The method change resulted in a positive section 481(a) adjustment of \$200,000 to be taken into account over four taxable years beginning in 2005. D's taxable income from January 1, 2006, through March 31, 2006, prior to any section 481(a) adjustment, is \$500,000. For purposes of determining D's first annualized income installment for its 2006 taxable year, D's annualized taxable income is \$2,050,000, determined by placing the sum of D's first three months of taxable income from January 1, 2006, through March 31, 2006, (\$500,000) plus, pursuant to paragraph (f)(2)(iv) of this section, the portion of the section 481(a) adjustment required to be recognized during the taxable year ($\$200,000/4 = \$50,000$) that is attributable to the period from January 1, 2006, through March 31, 2006, ($\$50,000 \times 3/12 = \$12,500$) on an annualized basis ($\$512,500 \times 12/3 = \$2,050,000$).

Example 6. Corporation E, a calendar year taxpayer, uses an accrual method of accounting and the annualized income installment method under section 6655(e)(2)(A)(i) to calculate all of its required installment payments for its 2006 taxable year. E's taxable income from January 1, 2006, through March 31, 2006, prior to any section 481(a) adjustment, is \$500,000. On June 30, 2006, E filed a copy of the Form 3115 with the IRS National Office to request a change in method of accounting that was permitted to be made with the automatic consent of the Commissioner and resulted in a negative section 481(a) adjustment of \$400,000 to be taken into account entirely in 2006. For purposes of determining E's first annualized income installment for its 2006 taxable year, E's annualized taxable income is \$2,000,000, determined by placing E's first three months of taxable income from January 1, 2006, through March 31, 2006, (\$500,000) on an annualized basis ($\$500,000 \times 12/3 = \$2,000,000$). Because E did not file the accounting method change

request until after the last day of the annualization period, no portion of the section 481(a) adjustment is taken into account in computing E's first annualized income installment.

Example 7. Same facts as Example 6 except that E's taxable income from January 1, 2006, through June 30, 2006, prior to any section 481(a) adjustment, is \$800,000. For purposes of determining E's third annualized income installment for its 2006 taxable year, E's annualized taxable income is \$1,200,000, determined by placing the sum of E's first six months of taxable income from January 1, 2006, through June 30, 2006, (\$800,000) less, pursuant to paragraph (f)(2)(iv) of this section, the portion of the 2006 section 481(a) adjustment required to be recognized during the taxable year that is attributable to the period from January 1, 2006, through June 30, 2006 ($\$400,000 \times 6/12 = \$200,000$) on an annualized basis ($\$600,000 \times 12/6 = \$1,200,000$).

Example 8. Same facts as Example 7 except that E's request for change in method of accounting required the prior consent of the Commissioner and the Form 3115 was filed with the IRS National Office on June 30, 2006. On December 10, 2006, E received the consent of the Commissioner to change its method of accounting. E signed and mailed the consent letter to the IRS National Office on December 15, 2006. For purposes of determining E's third annualized income installment for its 2006 taxable year, E's annualized taxable income is \$1,600,000, determined by placing E's first six months of taxable income from January 1, 2006, through June 30, 2006, on an annualized basis ($\$800,000 \times 12/6 = \$1,600,000$). No portion of the section 481(a) adjustment is taken into account in computing E's third annualized income installment because, although E filed the accounting method change request on or before the last day of E's third annualization period, E did not receive the Commissioner's consent to change its method of accounting, and E did not sign and mail the consent agreement to the IRS National Office, on or before the last day of E's third annualization period.

Example 9. Corporation F, a calendar year taxpayer that began business on January 1, 2003, adopted an accrual method of accounting and will use the annualized income installment method under section 6655(e)(2)(A)(i) to calculate its first required installment payment for its 2003 taxable year. As of March 31, 2003, F has purchased and placed in service \$100,000 of "5-year property," as defined in section 168(e), and anticipates purchasing and placing in service another \$100,000 of "5-year property" before December 31, 2003. F does not anticipate being subject to the mid-quarter convention for

the 2003 taxable year, does not anticipate making any depreciation elections for this class of property, does not anticipate making a section 179 election, will deduct the 30% additional first year depreciation deduction, does not anticipate any sales or other dispositions of depreciable property, and no events have occurred, and, based on all relevant information available as of the due date of F's first required installment, F does not know of any event that will cause F's taxable year to be a short taxable year. F's annual depreciation expense for 2003 is estimated to be \$88,000 (total depreciation deduction under section 168(k) of \$60,000 ($\$200,000 \times 30\% = \$60,000$) plus annual depreciation of \$28,000 ($(\$200,000 \text{ minus } \$60,000) \times 20\%$)). For purposes of determining F's first annualized income installment for its 2003 taxable year, in accordance with paragraph (f)(2)(v)(A) of this section, depreciation expense of \$22,000 ($\$88,000 \times 3/12 = \$22,000$) may be taken into account in computing F's January 1, 2003, through March 31, 2003, taxable income to be annualized. Under paragraph (f)(2)(v)(B) of this section, F may not consider its first annualization period to be a short taxable year for purposes of determining the depreciation allowance for such annualization period.

Example 10. Corporation G, a calendar year taxpayer that began business on January 5, 2004, adopted an accrual method of accounting and will use the annualized income installment method under section 6655(e)(2)(A)(i) to calculate its first required installment payment for its 2005 taxable year. On January 5, 2004, G purchased and placed in service an asset that cost \$30,000, qualifies as "5-year property" as defined in section 168(e), is eligible for the 50% additional first year depreciation deduction under section 168(k), and is subject to the half-year convention. G will deduct the 50% additional first year depreciation deduction with respect to the "5-year property." For tax year 2004, G takes a depreciation deduction under section 168(k) of \$18,000 ($\$15,000 (\$30,000 \times 50\% = \$15,000)$ plus annual depreciation of \$3,000 ($\$15,000 \times 20\% = \$3,000$)). G does not anticipate being subject to the mid-quarter convention for the 2004 taxable year, does not anticipate making any depreciation elections for this class of property, does not anticipate making a section 179 election, will deduct the 50% additional first year depreciation deduction, does not anticipate any sales or other dispositions of depreciable property, and no events have occurred, and, based on all relevant information available as of the due date of G's first required installment, G does not know of any event that will cause G's taxable year to be a short taxable year. G's annual depreciation expense for 2005 is estimated to be \$4,800 ($\$15,000 \times 32\% = \$4,800$). For purposes of determining G's first annualized

income installment for its 2005 taxable year, in accordance with paragraph (f)(2)(v)(A) of this section, depreciation expense of \$1,200 ($\$4,800 \times 3/12 = \$1,200$) may be taken into account in computing G's January 1, 2005, through March 31, 2005, taxable income to be annualized. As an alternative to estimating annual depreciation expense based on events that are reasonably expected to occur, depreciation expense of at least \$600 ($\$4,800 \times 50\% \times 3/12 = \600) may be taken into account in computing G's January 1, 2005, through March 31, 2005, taxable income to be annualized. Under paragraph (f)(2)(v)(B) of this section, G may not consider its first annualization period to be a short taxable year for purposes of determining the depreciation allowance for such annualization period.

Example 11. Corporation H, a calendar year taxpayer, uses an accrual method of accounting and the annualized income installment method under section 6655(e)(2)(A)(i) to calculate all of its required installment payments for its 2006 taxable year. H has owned real property in State Y since 2002 and has used the real property in its trade or business. H's method of accounting for real estate taxes is to deduct the taxes on the lien date, subject to the recurring item exception of §1.461-5. Based on historical practice for the past five years, for the 2006 calendar year State Y imposes a lien for real estate taxes on real property owned in State Y on March 15, 2006, with 90% of the tax due on June 30, 2006, and the remaining 10% of the tax due on June 29, 2007. Based on the value of H's real property in State Y, H's real estate tax liability lien imposed on March 15, 2006, is \$100,000. H pays the first 90% of this liability on June 30, 2006, and the remaining 10% on June 29, 2007. Under paragraph (f)(1)(iii) of this section, the \$100,000 real estate tax liability is not taken into account for purposes of determining H's first annualized income installment, which is based on the income and deductions from the first three months of the taxable year, because economic performance with respect to the real estate tax liability did not occur by March 31, 2006. However, pursuant to paragraph (f)(2)(i)(A) of this section, because H has historically incurred a real estate tax expense after the end of the taxable year and the real estate tax expense was deemed incurred in 2006 pursuant to §1.461-5, and because H satisfies the other requirements of paragraph (f)(2)(i)(A) of this section, a \$2,500 real estate tax expense may be taken into account for purposes of determining H's taxable income to be annualized in computing H's first annualized income installment ($\$10,000/12 \times 3 = \$2,500$) unless, pursuant to paragraph (f)(2)(i)(B) of this section, H is able to clearly demonstrate that the real estate tax expense is more

appropriately allocable by some other method.

Example 12. Same facts as Example 11, except that H is computing its third required installment payment for H's 2006 taxable year. Pursuant to paragraph (f)(1)(iii) of this section, H may take into account \$90,000 (\$100,000 real estate tax liability X 90% paid on June 30, 2006) for purposes of determining the taxable income to be annualized in computing H's third annualized income installment because economic performance with respect to \$90,000 of the real estate tax liability occurred by June 30, 2006. In addition, pursuant to paragraph (f)(2)(i)(A) of this section, because H has historically incurred a real estate tax expense after the end of the taxable year and the real estate tax expense was deemed incurred in 2006 pursuant to §1.461-5, and because H satisfies the other requirements of paragraph (f)(2)(i)(A) of this section, a \$5,000 real estate tax expense also may be taken into account for purposes of determining H's taxable income to be annualized in computing H's third annualized income installment ($\$10,000/12 \times 6 = \$5,000$) unless, pursuant to paragraph (f)(2)(i)(B) of this section, H is able to clearly demonstrate that \$10,000 of the real estate tax expense is more appropriately allocable by some other method. Therefore, pursuant to paragraphs (f)(1)(iii) and (f)(2)(i)(A) of this section, H may take into account \$95,000 of the real estate tax liability for purposes of computing the third required installment payment for H's 2006 taxable year.

Example 13. Same facts as Example 11, except that H pays 90% of the real estate tax liability on June 30, 2006, and the remaining 10% of the real estate tax liability on November 30, 2006. Under paragraph (f)(1)(iii) of this section, the \$100,000 real estate tax liability is not taken into account for purposes of determining H's first annualized income installment, which is based on the income and deductions from the first three months of the taxable year, because economic performance with respect to the real estate tax liability did not occur by March 31, 2006. In addition, although H has a history of incurring a real estate tax expense after the end of the taxable year that is deemed incurred during the taxable year, H does not meet the requirements of paragraph (f)(2)(i)(A) of this section in order to take a real estate tax expense into account for purposes of determining H's first annualized income installment because H does not incur a real estate tax at the end of the current taxable year or after the end of the current taxable year that will be deemed incurred during the current taxable year.

Example 14. Same facts as Example 13 except that H is

computing its third required installment payment for H's 2006 taxable year. Pursuant to paragraph (f)(1)(iii) of this section, H may take into account \$90,000 (\$100,000 real estate tax liability X 90% paid on June 30, 2006) for purposes of determining the taxable income to be annualized in computing H's third annualized income installment because economic performance with respect to \$90,000 of the real estate tax liability occurred by June 30, 2006.

Example 15. Corporation I, a calendar year taxpayer, uses an accrual method of accounting and the annualized income installment method under section 6655(e)(2)(A)(i) to calculate all of its required installment payments for its 2006 taxable year. As of December 31, 2005, I had a \$1,000,000 account receivable due from Z related to the sale of goods from I to Z during 2005. I has traditionally incurred bad debt expense for worthless accounts receivable and, as of January 1, 2006, I projects that it will have a bad debt expense of \$1,600,000 under section 166 and the regulations for its calendar year 2006. On March 31, 2006, I determined that its receivable from Z was totally worthless under section 166 and the regulations. No other receivables were determined to be worthless between January 1, 2006, and March 31, 2006. In accordance with paragraph (f)(1)(ii) of this section, a \$1,000,000 bad debt write-off is taken into account for purposes of determining the taxable income to be annualized in computing I's first annualized income installment.

Example 16. Same facts as Example 15 except that I determines that its receivable from Z was totally worthless under section 166 and the regulations on April 10, 2006. As of March 31, 2006, I had not determined that any receivables were worthless under section 166 and the regulations. In accordance with paragraph (f)(1)(ii) of this section, the \$1,000,000 bad debt expense attributable to the receivable from Z is not taken into account for purposes of determining the taxable income to be annualized in computing I's first annualized income installment, which is based on the income and deductions from the first three months of the taxable year, because the receivable from Z became totally worthless after the last day of I's annualization period. Furthermore, I may not take the bad debt expense into account for purposes of determining the taxable income to be annualized in computing I's first annualized income installment because the receivable from Z does not meet the requirements of paragraph (f)(2)(i) of this section.

Example 17. Corporation J, a calendar year taxpayer, uses an accrual method of accounting and the annualized income installment

method under section 6655(e)(2)(A)(i) to calculate its first required installment payment for its 2006 taxable year. J projects its annualized tax for its 2006 taxable year, based on annualizing J's taxable income for its first annualization period from January 1, 2006, through March 31, 2006, to be \$1,500,000 before reduction for any credits. J has an unused credit for increasing research activities from 2005 of \$500,000 that is carried over to 2006. For purposes of determining J's first annualized income installment, J's annualized tax for 2006 is \$1,000,000, determined as the tax for the taxable year computed by placing on an annualized basis J's taxable income from its first annualization period from January 1, 2006, through March 31, 2006, (\$1,500,000) reduced by the \$500,000 credit carryover from 2005.

Example 18. Corporation K, a calendar year taxpayer, uses an accrual method of accounting and the annualized income installment method under section 6655(e)(2)(A)(i) to calculate its first required installment payment for its 2006 taxable year. K projects its annualized tax for its 2006 taxable year, based on annualizing K's taxable income for its first annualization period from January 1, 2006, through March 31, 2006, to be \$2,000,000 before reduction for any credits. K has historically earned a credit for increasing research activities and, for 2006, K estimates that it will earn a credit for increasing research activities under section 41 of \$1,200,000. However, pursuant to paragraph (f)(1)(vi) of this section, if K were to annualize all components involved in computing the current year credit based on K's activity from January 1, 2006, through March 31, 2006, K would generate a credit of \$1,600,000 for 2006. For purposes of determining K's first annualized income installment, K's annualized tax for 2006 is \$400,000, determined as the tax for the 2006 taxable year (\$2,000,000) computed by placing on an annualized basis K's taxable income from its first annualization period January 1, 2006, through March 31, 2006, reduced by a \$1,600,000 current year credit from increasing research activities.

Example 19. Same facts as Example 18 except that K does not begin any research activities until April 3, 2006, and will not incur any research expenses described in paragraph (f)(2)(i) of this section. As a result, if K were to annualize all components involved in computing the current year credit based on K's activity from January 1, 2006, through March 31, 2006, K would generate no section 41 research credit for purposes of determining its first annualized income installment. Pursuant to paragraph (f)(1)(vi) of this section, K can not take into account any credit for its first

annualization period because K did not incur the credit by the last day of the first annualization period. Accordingly, for purposes of determining K's first annualized income installment, K's annualized tax for its first annualization period January 1, 2006, through March 31, 2006, is \$2,000,000.

Example 20. Corporation L, a calendar year taxpayer, uses an accrual method of accounting and the annualized income installment method under section 6655(e)(2)(A)(i) to calculate its first required installment payment for its 2006 taxable year. L has licensed technology from Corporation M for the past five years. Pursuant to the license agreement, L pays a license fee to M equal to \$.01 for every dollar of gross receipts earned by L. For 2006, L projects gross receipts of \$200,000,000, of which \$100,000,000 is earned by March 31, 2006, and no portion of L's license fee expense is described in paragraph (f)(2)(i) of this section. Pursuant to paragraph (f)(1)(iii) of this section, a license fee expense of \$1,000,000 ($\$100,000,000 \times \$.01$) is incurred by March 31, 2006, and may be taken into account for purposes of determining the taxable income to be annualized in computing L's first annualized income installment.

Example 21. Same facts as Example 20 except that L does not earn any gross receipts by March 31, 2006. In accordance with paragraph (f)(1)(iii) of this section, because the license fee expense was not incurred under §1.461-1(a)(2) by the last day of the annualization period, no license fee expense is taken into account for purposes of determining the taxable income to be annualized in computing L's first annualized income installment, which is based on the income and deductions from the first three months of the taxable year.

Example 22. Corporation N is a calendar year taxpayer that produces and sells candy bars. N uses an accrual method of accounting and the annualized income installment method under section 6655(e)(2)(A)(i) to calculate all of its required installment payments for its 2007 taxable year. N annually conducts, and will conduct for 2007 and 2008, a contest for its customers whereby N awards, on a quarterly basis, a cash prize of \$100,000, \$200,000, \$300,000, and \$400,000 to the first, second, third, and fourth quarter winners, respectively. Winners are announced on the last day of each calendar quarter and the prize is payable on the last day of the month following the announcement of the winner. N uses the recurring item exception of section 461(h) and the regulations with respect to its liability to the prize

winner. On December 31, 2006, N announced its fourth quarter winner and remitted payment of \$400,000 to the winner on January 31, 2007. Although the contest liability is incurred in accordance with §1.461-4(g)(4) on January 31, 2007, at the time payment is made to the award winner, N may not take such item into account in computing N's first annualized income installment for 2007 because, pursuant to the recurring item exception, the \$400,000 is deductible in determining N's 2006 taxable income and is not taken into account in determining N's taxable income for 2007, as required pursuant to paragraph (f)(1) of this section. However, because N has historically incurred an annual prize expense of \$400,000 that is described in paragraph (f)(2)(i)(A) of this section, \$100,000 may be taken into account for purposes of determining the taxable income to be annualized in computing N's first annualized income installment for N's 2007 taxable year based on the \$400,000 liability N will incur for the 2007 taxable year when N makes the payment in January of 2008 to the 2007 fourth quarter winner ($\$400,000/12 \times 3 = \$100,000$), unless, pursuant to paragraph (f)(2)(i)(B) of this section, N is able to clearly demonstrate that the annual prize expense is more appropriately allocable by some other method.

(g) Items that substantially affect taxable income but cannot be determined accurately by the installment due date--(1) In general. In determining the applicability of the annualization exceptions described in paragraphs (a) and (b) of this section and §1.6655-3, reasonable estimates may be made from existing data for items that substantially affect income if the amount of such items cannot be determined accurately by the installment due date. Examples of these items are the inflation index for taxpayers using the dollar-value LIFO (last-in, first-out) inventory method, intercompany adjustments for taxpayers that file consolidated returns, and the liquidation of a LIFO layer at the installment date that the taxpayer reasonably believes will be replaced at the end of

the year.

(2) Example. The following example illustrates the rules of this paragraph (g):

Example. Corporation X accounts for its inventory using the dollar-value LIFO method of accounting. If, when computing its first annualized income installment, no reliable inflation index exists for the period January 1, 2006, through March 31, 2006, X may interpolate from an available inflation index for the same months in the previous year to calculate its cost of goods sold.

(h) Events arising after installment due date that were not reasonably foreseeable--(1) In general. Events arising subsequent to an installment due date that cause the taxpayer's computation of its taxable income for a prior installment period to be understated will not result in a recomputation of its taxable income for the prior installment period. The preceding sentence applies only if, based on all the facts and circumstances as of the due date of an installment payment, it was not reasonably foreseeable that these subsequent events would occur.

(2) Example. The following example illustrates the rules of this paragraph (h):

Example. Assume that Congress enacts retroactively effective legislation that causes the taxable income for the applicable 2-, 3-, 4-, 5-, 6-, 7-, 8-, 9-, 10- or 11-month period to be understated. This event, which occurs after the applicable installment due date and was not reasonably foreseeable at the time the installment payment was made, will not result in a recomputation of a corporation's taxable income for the applicable installment period because such an event was not reasonably foreseeable.

(i) Effective date. This section applies to taxable years

beginning after the date that is 30 days after the date the final regulations are published in the **Federal Register**.

§1.6655-3 Adjusted seasonal installment method.

(a) In general. In the case of any required installment, the amount of the adjusted seasonal installment is the excess (if any) of--

(1) 100 percent of the amount determined under paragraph (c) of this section; over

(2) The aggregate amount of all prior required installments for the taxable year.

(b) Limitation on application of section. This section shall apply only if the base period percentage (as defined in section 6655(e)(3)(D)(i) and paragraph (d)(1) of this section) for any six consecutive months of the taxable year equals or exceeds seventy percent.

(c) Determination of amount. The amount determined under this section for any installment will be determined in the following manner--

(1) Take the taxable income for all months during the taxable year preceding the filing month;

(2) Divide such amount by the base period percentage for all months during the taxable year preceding the filing month;

(3) Determine the tax on the amount determined under paragraph

(c)(2) of this section; and

(4) Multiply the tax computed under paragraph (c)(3) of this section by the base period percentage for the filing month and all months during the taxable year preceding the filing month.

(d) Special rules--(1) Base period percentage. The base period percentage for any period of months shall be the average percent that the taxable income for the corresponding months in each of the three preceding taxable years bears to the taxable income for the three preceding taxable years.

(2) Filing month. The term filing month means the month in which the installment is required to be paid.

(3) Application of the rules related to the annualized income installment method to the adjusted seasonal installment method. The rules governing the computation of taxable income (and resulting tax) for purposes of determining any required installment payment of estimated tax under the annualized income installment method under §1.6655-2 shall apply to the computation of taxable income (and resulting tax) for purposes of determining any required installment payment of estimated tax under the adjusted seasonal installment method.

(e) Example. The provisions of this section may be illustrated by the following example:

Example. (i) X, a corporation that reports on a calendar year

basis, expected that it would have an estimated tax liability of \$1,200,000 for its taxable year ending December 31, 2006. On its 2005 tax return, X reported a tax liability of \$652,800. X paid four installments of estimated tax, each in the amount of \$250,000, \$250,000, \$250,000, and \$450,000 on April 17, 2006, June 15, 2006, September 15, 2006, and December 15, 2006, respectively. X reported a tax liability of \$1,152,600 on its return due March 15, 2007, with no credits against tax. Under the general provision of section 6655(b) and section 6655(d), there was an underpayment in the amount of \$76,300 for the second installment through September 15, 2006, and \$114,450 for the third installment through December 15, 2006, determined as follows:

(A) Tax as defined in section 6655(g)	\$1,152,600
(B) 100% of this paragraph (e), <u>Example (i)(A)</u>	1,152,600
(C) Amount of estimated tax required to be paid on or before the first installment (25% of \$652,800)	163,200
(D) Deduct amount timely paid on or before the first installment due date under the general rule of section 6655(b)	250,000
(E) Amount of overpaid estimated tax for the first installment date	86,800
(F) Amount of estimated tax required to be paid on or before the second installment (25% of \$1,152,600 plus the recapture amount under section 6655(d)(2)(B) of \$124,950 (25% of \$1,152,600 less 163,200))	413,100
(G) Deduct amount paid on or before the due date of the second installment less amount applied towards the first installment under the general rule of section 6655(b) (\$250,000 paid in each of the first and second installments less this paragraph (e), <u>Example (i)(C)</u>)	336,800
(H) Amount of underpayment for the second installment date	76,300
(I) Amount of estimated tax required to be paid on or before the third installment (25% of \$1,152,600)	288,150

(J) Deduct amount paid on or before the due date of the third installment less amount applied towards the first and second installments under the general rule of section 6655(b) (\$250,000 paid in each of the first, second, and third installments less this paragraph (e), Example (i)(C) less this paragraph (e), Example (i)(F)) 173,700

(K) Amount of underpayment for the third installment date 114,450

(L) Amount of estimated tax required to be paid on or before the fourth installment (25% of \$1,152,600) 288,150

(M) Deduct amount paid on or before the due date of the fourth installment less amount applied towards the first, second, and third installments under the general rule of section 6655(b) (\$250,000 paid in each of the first, second, and third installments plus \$450,000 paid in the fourth installment less this paragraph (e), Example (i)(C) less this paragraph (e), Example (i)(F) less this paragraph (e), Example (i)(I)) 335,550

(N) Amount of overpaid estimated tax for the fourth installment date 47,400

(ii) X wants to determine if it qualifies for the adjusted seasonal installment method. X determines that its monthly taxable income for the preceding three taxable years and for the current taxable year 2006 is as follows:

<u>January</u>	<u>February</u>	<u>March</u>	<u>April</u>	<u>May</u>	<u>June</u>
<u>2003</u>					
\$100,000	\$90,000	\$80,000	\$70,000	\$60,000	\$20,000
<u>2004</u>					
200,000	170,000	170,000	130,000	125,000	45,000
<u>2005</u>					
410,000	350,000	330,000	270,000	240,000	80,000
<u>2006</u>					

600,000	680,000	650,000	560,000	460,000	170,000
<u>July</u>	<u>August</u>	<u>September</u>	<u>October</u>	<u>November</u>	<u>December</u>
<u>2003</u>					
\$10,000	\$10,000	\$10,000	\$10,000	\$10,000	\$10,000
<u>2004</u>					
21,000	19,000	20,000	20,000	20,000	20,000
<u>2005</u>					
40,000	40,000	40,000	40,000	40,000	40,000
<u>2006</u>					
70,000	60,000	50,000	40,000	30,000	20,000

(iii) X must initially determine if its base period percentage for the same 6 consecutive months of the 3 preceding taxable years equals or exceeds 70 percent (see section 6655(e)(3) and paragraphs (b) and (c) of this section). By using its taxable income for the first 6 months of 2003, 2004, and 2005, X qualifies for the adjusted seasonal installment method because its base period percentage is 87.5 percent (which exceeds 70 percent) computed as follows:

(A) Taxable income for first 6 months of 2003	\$420,000
(B) Total taxable income for 2003	480,000
(C) Divide this paragraph (e), <u>Example</u> (iii)(A) by this paragraph (e), <u>Example</u> (iii)(B)	.875
(D) Taxable income for first 6 months of 2004	840,000
(E) Total taxable income for 2004	960,000
(F) Divide this paragraph (e), <u>Example</u> (iii)(D) by this paragraph (e), <u>Example</u> (iii)(E)	.875
(G) Taxable income for first 6 months of 2005	1,680,000
(H) Total taxable income for 2005	1,920,000
(I) Divide this paragraph (e), <u>Example</u> (iii)(G) by this paragraph (e), <u>Example</u> (iii)(H)	.875

(J) Add this paragraph (e), Example (iii)(C),
(F), and (I) 2.625

(K) Divide this paragraph (e), Example (iii)(J) by 3 .875

(iv) To determine the amount of the first installment under the rules of section 6655(e)(3) and paragraph (a) of this section, the following computation is necessary:

(A) Taxable income for first 3 months of 2006 \$1,930,000

(B) Taxable income for first 3 months of 2003
(\$270,000) divided by total taxable income for 2003
(\$480,000) .5625

(C) Taxable income for first 3 months of 2004
(\$540,000) divided by total taxable income for 2004
(\$960,000) .5625

(D) Taxable income for first 3 months of 2005
(\$1,090,000) divided by total taxable income for 2005
(\$1,920,000) .5677

(E) Add this paragraph (e), Example (iv)(B), (C),
and (D) and divide by 3 .5642

(F) Divide this paragraph (e), Example (iv)(A)
by this paragraph (e), Example (iv)(E) 3,420,773

(G) Determine the tax on this paragraph (e),
Example (iv)(F) 1,163,049

(H) Taxable income for first 4 months of 2003
(\$340,000) divided by total taxable income for 2003
(\$480,000) .7083

(I) Taxable income for first 4 months of 2004
(\$670,000) divided by total taxable income for 2004
(\$960,000) .6979

(J) Taxable income for first 4 months of 2005
(\$1,360,000) divided by total taxable income for 2005
(1,920,000) .7083

(K) Add this paragraph (e), Example (iv)(H), (I), and (J) and divide by 3 .7048

(L) Multiply this paragraph (e), Example (iv)(G) by this paragraph (e), Example (iv)(K) 819,717

(M) 100% of this paragraph (e), Example (iv)(L) 819,717

(N) Amount of all prior required installments for 2006 0

(O) Amount of adjusted seasonal installment for the first installment payment (this paragraph (e), Example (iv)(M) less this paragraph (e), Example (iv)(N)) 819,717

(v) To determine the amount of the second installment under the rules of section 6655(e)(3) and paragraph (a) of this section, the following computation is necessary:

(A) Taxable income for first 5 months of 2006 \$2,950,000

(B) Taxable income for first 5 months of 2003 (\$400,000) divided by total taxable income for 2003 (\$480,000) .8333

(C) Taxable income for first 5 months of 2004 (\$795,000) divided by total taxable income for 2004 (\$960,000) .8281

(D) Taxable income for first 5 months of 2005 (\$1,600,000) divided by total taxable income for 2005 (\$1,920,000) .8333

(E) Add this paragraph (e), Example (v)(B), (C), and (D) and divide by 3 .8316

(F) Divide this paragraph (e), Example (v)(A) by this paragraph (e), Example (v)(E) 3,547,379

(G) Determine the tax on this paragraph (e), Example (v)(F) 1,206,109

(H) Taxable income for first 6 months of 2003 (\$420,000) divided by total taxable income for 2003 (\$480,000) .875

(I) Taxable income for first 6 months of 2004
(\$840,000) divided by total taxable income for 2004
(\$960,000) .875

(J) Taxable income for first 6 months of 2005
(\$1,680,000) divided by total taxable income for 2005
(\$1,920,000) .875

(K) Add this paragraph (e), Example (v)(H), (I),
and (J) and divide by 3 .875

(L) Multiply this paragraph (e), Example (v)(G)
by this paragraph (e), Example (v)(K) 1,055,345

(M) 100% of this paragraph (e), Example (v)(L) 1,055,345

(N) Amount of all prior required installments for
2006 163,200

(O) Amount of adjusted seasonal installment for the
second installment payment (this paragraph (e), Example
(v)(M) less this paragraph (e), Example (v)(N)) 892,145

(vi) To determine the amount of the third installment under the
rules of section 6655(e)(3) and paragraph (a) of this section, the
following computation is necessary:

(A) Taxable income for first 8 months of 2006 \$3,250,000

(B) Taxable income for first 8 months of 2003
(\$440,000) divided by total taxable income for 2003
(\$480,000) .9167

(C) Taxable income for first 8 months of 2004
(\$880,000) divided by total taxable income for 2004
(\$960,000) .9167

(D) Taxable income for first 8 months of 2005
(\$1,760,000) divided by total taxable income for 2005
(\$1,920,000) .9167

(E) Add this paragraph (e), Example (vi)(B), (C),
and (D) and divide by 3 .9167

(F) Divide this paragraph (e), Example (vi)(A) by this paragraph (vi)(E) 3,545,326

(G) Determine the tax on this paragraph (e), Example (vi)(F) 1,205,411

(H) Taxable income for first 9 months of 2003 (\$450,000) divided by total taxable income for 2003 (\$480,000) .9375

(I) Taxable income for first 9 months of 2004 (\$900,000) divided by total taxable income for 2004 (\$960,000) .9375

(J) Taxable income for first 9 months of 2005 (\$1,800,000) divided by total taxable income for 2005 (\$1,920,000) .9375

(K) Add this paragraph (e), Example (vi)(H), (I), and (J) and divide by 3 .9375

(L) Multiply this paragraph (e), Example (vi)(G) by this paragraph (e), Example (vi)(K) 1,130,073

(M) 100% of this paragraph (e), Example (vi)(L) 1,130,073

(N) Amount of all prior required installments for 2006 576,300

(O) Amount of adjusted seasonal installment for the third installment payment (this paragraph (e), Example (vi)(M) less this paragraph (e), Example (vi)(N)) 553,773

(vii) To determine the amount of the fourth installment under the rules of section 6655(e)(3) and paragraph (a) of this section, the following computation is necessary:

(A) Taxable income for first 11 months of 2006 \$3,370,000

(B) Taxable income for first 11 months of 2003 (\$470,000) divided by total taxable income for 2003 (\$480,000) .9792

(C) Taxable income for first 11 months of 2004 (\$940,000) divided by total taxable income for 2004

(\$960,000) .9792

(D) Taxable income for first 11 months of 2005
(\$1,880,000) divided by total taxable income for 2005
(\$1,920,000) .9792

(E) Add this paragraph (e), Example (vii)(B), (C),
and (D) and divided by 3 .9792

(F) Divide this paragraph (e), Example (vii)(A) by
this paragraph (e), Example (vii)(E) 3,441,585

(G) Determine the tax on this paragraph (e),
Example (vii)(F) 1,170,139

(H) Taxable income for first 12 months of 2003
(\$480,000) divided by total taxable income for 2003
(\$480,000) 1.0000

(I) Taxable income for first 12 months of 2004
(\$960,000) divided by total taxable income for 2004
(\$960,000) 1.0000

(J) Taxable income for first 12 months of 2005
(\$1,920,000) divided by total taxable income for 2005
(\$1,920,000) 1.0000

(K) Add this paragraph (e), Example (vii)(H), (I),
and (J) and divide by 3 1.0000

(L) Multiply this paragraph (e), Example (vii)(G)
by this paragraph (e), Example (vi)(K) 1,170,139

(M) 100% of this paragraph (e), Example (vii)(L) 1,170,139

(N) Amount of all prior required installments for
2006 864,450

(O) Amount of adjusted seasonal installment for the
fourth installment payment (this paragraph (e), Example
(vii)(M) less this paragraph (e), Example (vii)(N)) 305,689

(viii) Because the total amount of each required estimated tax
payment determined under section 6655(e)(3) and paragraph (a) of
this section exceeds the amount of each required estimated tax

payment determined under section 6655(d) and §1.6655-1(d) and (e), the exception described in section 6655(e) and this section does not apply and the addition to the tax with respect to the underpayment for the June 15, 2006, and September 15, 2006, installments will be imposed unless another exception (for example, see section 6655(e)(2)) applies with respect to these installments.

(f) Effective date. This section applies to taxable years beginning after the date that is 30 days after the date the final regulations are published in the **Federal Register**.

Par. 8. Section 1.6655-4 is added to read as follows:

§1.6655-4 Large corporations.

(a) Large corporation defined. The term large corporation means any corporation (or a predecessor corporation) that had taxable income of at least \$1,000,000 for any taxable year during the testing period. For purposes of this section, a predecessor corporation is the distributor or transferor corporation in a transaction to which section 381 (relating to carryovers in certain corporate acquisitions) applies.

(b) Testing period. For purposes of paragraph (a) of this section, the term testing period means the 3 taxable years immediately preceding the taxable year for which estimated tax is being determined (the current taxable year) or, if less, the number of taxable years the taxpayer has been in existence.

(c) Computation of taxable income during testing period--

(1) Short taxable year. In the case of a corporation (or

predecessor corporation) that had a short taxable year during the testing period, for purposes of determining whether the \$1,000,000 amount referred to in paragraph (a) of this section is equaled or exceeded, the taxable income for the short taxable year is computed by--

(i) Multiplying the taxable income for the short taxable year by 12; and

(ii) Dividing the resulting amount by the number of months in the short taxable year.

(2) Computation of taxable income in taxable year when there occurs a transaction to which section 381 applies. (i) For purposes of determining whether an acquiring corporation had taxable income of \$1,000,000 or more for a taxable year in which there occurs a transaction to which section 381 applies, the acquiring corporation's taxable income will be the sum of--

(A) The taxable income of the acquiring corporation for its taxable year; plus

(B) The taxable income of the distributor or transferor corporation for that portion of the acquiring corporation's taxable year up to and including the date of distribution or transfer (as defined in §1.381(b)-1(b)).

(ii) For purposes of determining whether a transferor or distributor corporation had taxable income of \$1,000,000 or more for

a taxable year in which there occurs a transaction to which section 381 applies, the distributor or transferor corporation's taxable income shall be reduced by the amount of its taxable income for that portion of its taxable year corresponding to the acquiring corporation's taxable year up to and including the date of distribution or transfer (as defined in §1.381(b)-1(b)).

(d) Members of controlled group--(1) In general. For purposes of applying paragraph (a) of this section, the taxable income of members of a controlled group of corporations (as defined in section 1563(a)) must be aggregated for each year of the testing period. The provisions of this section shall not apply to a controlled group for any taxable year in which the aggregate taxable income of the members of the controlled group is less than \$1,000,000.

(2) Aggregation. For purposes of paragraph (d)(1) of this section, a taxable loss of any member of the controlled group for a taxable year during the testing period is not taken into account.

(3) Allocation rule. If the aggregate taxable income of members of a controlled group computed pursuant to paragraph (d)(1) of this section exceeds \$1,000,000 during the testing period, the \$1,000,000 amount that is relevant for purposes of determining, under paragraph (a)(1) of this section, whether a corporation is a large corporation shall be divided equally among the component members of such group (including component members excluded pursuant

to paragraph (d)(2) of this section) unless all of such component members consent to an apportionment plan providing for an alternative allocation of such amount. The procedure for making and filing this plan will be the same as the procedure used for making and filing an apportionment plan under section 1561. See section 1561 and the regulations.

(4) Controlled group members. (i) In the case of any corporation that was a member of a controlled group of corporations at any time during the testing period but is not a member of such group during the taxable year involved, the taxable income of the former member for the testing period is determined as if such corporation were not a member of a group at any time during that period. With respect to the controlled group, the taxable income of its former member will not be taken into account in determining such group's taxable income for any taxable year during the testing period for purposes of applying paragraph (a)(1) of this section.

(ii) For purposes of paragraph (d)(4)(i) of this section, the determination of whether a corporation is a member of a controlled group during the testing period is based on whether the corporation was a member of the controlled group on the last day of the month preceding the due date of the required installment.

(e) Effect on a corporation's taxable income of items that may be carried back or carried over from any other taxable year. In

determining whether a corporation (or predecessor corporation) is a large corporation for its current taxable year, items that could offset taxable income during a taxable year included in the testing period (for example, those described in sections 172 and 1212) are not to be taken into account and the taxable income of a corporation for any taxable year during the testing period shall be determined without regard to items carried back or carried over from any other taxable year.

(f) Consolidated returns. [Reserved].

(g) Example. The provisions of this section may be illustrated by the following example:

Example. Y Corporation and Z Corporation are calendar year taxpayers. In 2006, Z acquires all of the assets of Y in a transaction to which section 381 applies. Z's taxable income for both 2004 and 2005 was less than \$1,000,000. Y's taxable income for 2006 is determined under paragraph (c)(2) of this section to be \$300,000 for that portion of the acquiring corporation's taxable year up to and including the date of transfer. Z's taxable income for 2006 is \$800,000. Under the provisions of paragraph (c)(2) of this section, Z's 2006 taxable income for purposes of determining whether it is a large corporation for taxable year 2007 is \$1,100,000 (\$800,000 + \$300,000). Thus, Z is a large corporation for the 2007 taxable year. In addition, if Z's 2006 taxable income, as determined under paragraph (c)(2) of this section, had been less than \$1,000,000 but Y's taxable income in 2004 or 2005 had been \$1,000,000 or more, Z would be a large corporation for taxable year 2007 because Y is a predecessor corporation.

(h) Effective date. This section applies to taxable years beginning after the date that is 30 days after the date the final regulations are published in the **Federal Register**.

§1.6655-7 [Removed]

Par. 9. Section 1.6655-7 is removed.

§1.6655-5 [Redesignated as §1.6655-7]

Par. 10. Section 1.6655-5 is redesignated as §1.6655-7.

Par. 11. Sections 1.6655-5 and 1.6655-6 are added to read as follows:

§1.6655-5 Short taxable year.

(a) In general. Except as otherwise provided in this section, the provisions of section 6655 and the regulations are applicable in the case of a short taxable year (including an initial taxable year) for which a payment of estimated tax is required to be made.

(b) Exception to payment of estimated tax. In the case of a short taxable year, no payment of estimated tax is required if--

(1) The short taxable year is a period of less than 4 full calendar months; or

(2) The tax shown on the return for such taxable year (or, if no return is filed, the tax) is less than \$500.

(c) Installment due dates--(1) In general--(i) Taxable year of four months but less than twelve months. Except as otherwise provided, in the case of a short taxable year, if such year results in a taxable year of four or more full calendar months but less than twelve full calendar months, the due dates prescribed in §1.6655-1(f)(2) shall apply.

(ii) Exception. If the date determined under paragraph (c)(1)(i) of this section for the first required installment due during the taxpayer's short taxable year is earlier than the 15th day of the fourth month of the taxpayer's short taxable year, the taxpayer's first required installment shall be due on the first due date otherwise determined under paragraph (c)(1)(i) of this section that is on or after the 15th day of the fourth month of the short taxable year.

(2) Early termination of taxable year--(i) In general. Except as provided in paragraph (c)(2)(ii) of this section, if a taxable year ends early (for example, as a result of an acquisition or a change in taxable year), the due date for the final required installment shall be the date that would have been the due date of the next required installment if the event that gave rise to the short taxable year had not occurred.

(ii) Exception. If the date determined under paragraph (c)(2)(i) of this section is within thirty days of the last day of the short taxable year, the due date for the final required installment shall be the fifteenth day of the second month following the month that includes the last day of the short taxable year.

(d) Amount due for required installment--(1) In general. The amount due for any required installment determined under section 6655(d)(1)(B)(i) for a short taxable year shall be 100% of the

required annual payment for the short taxable year divided by the number of required installments due (as determined under this section) for the short taxable year.

(2) Tax shown on the return for the preceding taxable year. If the current taxable year is a short taxable year, the amount due for any required installment determined under section 6655(d)(1)(B)(ii) shall be determined in the following manner--

(i) Take 100% of the tax shown on the return of the corporation for the preceding taxable year;

(ii) Multiply such amount by the number of full calendar months in the current short taxable year and divide by 12; and

(iii) Divide the amount determined under paragraph (d)(2)(ii) of this section by the number of required installments due (as determined under this section) for the current short taxable year.

(3) Applicable percentage. In the case of any required installment determined under section 6655(e), the applicable percentage under section 6655(e)(2)(B)(ii) shall be--

(i) 25%, 50%, 75%, and 100% for the first, second, third, and fourth (last) required installments, respectively, if the taxpayer will have four required installments due for the short taxable year;

(ii) 33.33%, 66.67%, and 100% for the first, second, and third (last) required installments, respectively, if the taxpayer will have three required installments due for the short taxable year;

(iii) 50% and 100% for the first and second (last) required installments, respectively, if the taxpayer will have two required installments due for the short taxable year; or

(iv) 100% for the first (and last) required installment if the taxpayer will have one required installment for the short taxable year.

(e) Examples. The following examples illustrate the rules of this section:

Example 1. A corporation is a calendar year taxpayer that was acquired by B corporation on April 16, 2007, resulting in A having a short taxable year from January 1 through April 16, 2007. Because A has a taxable year of less than four full calendar months, no estimated tax payments are required by A for the short taxable year.

Example 2. B corporation began business on January 10, 2007, and adopted a calendar year as its taxable year. B computes its required installments based on 100 percent of the tax shown on the return for the taxable year in accordance with section 6655(d)(1)(B)(i). Pursuant to §1.6655-1(f)(2)(i), the due dates of B's required installments for B's initial taxable year from January 10, 2007, through December 31, 2007, are April 15, 2007, June 15, 2007, September 15, 2007, and December 15, 2007. However, because the due dates for the first, third, and fourth required installments fall on a weekend, B's required installment payments will be timely if paid on or before the first business day following the actual due date of the required installments, that is, April 16, 2007, September 17, 2007, and December 17, 2007, respectively, for the first, third, and fourth required installments. Pursuant to paragraph (d)(1) of this section, the amount due with each required installment is 25% of the required annual payment for B's first required installment, 50% of the required annual payment for B's second required installment, 75% of the required annual payment for B's third required installment, and 100% of the required annual payment for B's fourth required installment.

Example 3. Corporation C began business on February 12, 2007, and adopted a calendar year as its taxable year. C computes its

required installments based on 100 percent of the tax shown on the return for the taxable year in accordance with section 6655(d)(1)(B)(i). Pursuant to §1.6655-1(f)(2)(i), the due dates of C's required installments for C's initial taxable year from February 12, 2007, through December 31, 2007, are April 15, 2007, June 15, 2007, September 15, 2007, and December 15, 2007. However, in accordance with paragraph (c)(1)(ii) of this section, C's first required installment is due June 15, 2007, because April 15, 2007, is earlier than the fifteenth day of the fourth month of C's taxable year. As a result, C's second required installment is due September 15, 2007, and C's third (and last) installment is due December 15, 2007. However, because the due dates for the second and third (and last) required installments fall on a weekend, C's required installment payments will be timely if paid on or before the first business day following the actual due date of the required installments, that is, September 17, 2007, and December 17, 2007, respectively, for the second and third (and last) required installments. Pursuant to paragraph (d)(1) of this section, the amount due with each required installment is 33.33% of the required annual payment for C's first required installment, 66.67% of the required annual payment for C's second required installment, and 100% of the required annual payment for C's third (and last) required installment.

Example 4. Same facts as Example 3 except C began business on April 10, 2007. In accordance with paragraph (c)(1)(ii) of this section, C's first required installment is due September 15, 2007, because April 15, 2007, and June 15, 2007, are earlier than the fifteenth day of the fourth month of C's taxable year. As a result, C's second (and last) required installment is due December 15, 2007. However, because the due dates for the first and second (and last) required installments fall on a weekend, C's required installment payments will be timely if paid on or before the first business day following the actual due date of the required installments, that is, September 17, 2007, and December 17, 2007, respectively, for the first and second (and last) required installments. Pursuant to paragraph (d)(1) of this section, the amount due with each required installment is 50% of the required annual payment for C's first required installment, and 100% of the required annual payment for C's second (and last) required installment.

Example 5. D corporation began business on February 12, 2007, and adopted a fiscal year ending October 31 as its taxable year. D computes its required installments based on 100 percent of the tax shown on the return for the taxable year in accordance with section

6655(d)(1)(B)(i). Pursuant to §1.6655-1(f)(2)(ii), the due dates of D's required installments for D's initial taxable year from February 12, 2007, through October 31, 2007, are February 15, 2007, April 15, 2007, July 15, 2007, and October 15, 2007. However, in accordance with paragraph (c)(1)(ii) of this section, D's first required installment is due July 15, 2007, because February 15, 2007, and April 15, 2007, are earlier than the fifteenth day of the fourth month of D's taxable year. As a result, D's second (and last) installment is due October 15, 2007. However, because the due date for the first required installment falls on a weekend, D's first required installment payment will be timely if paid on or before the first business day following the actual due date of the required installment, that is, July 16, 2007. Pursuant to paragraph (d)(1) of this section, the amount due with each required installment is 50% of the required annual payment for D's first required installment, and 100% of the required annual payment for D's second (and last) required installment.

Example 6. Same facts as Example 5 except D corporation began business on May 10, 2007. In accordance with paragraph (c)(1)(ii) of this section, D's first (and last) installment is due October 15, 2007, because July 15, 2007, is earlier than the fifteenth day of the fourth month of D's taxable year. Pursuant to paragraph (d)(1) of this section, the amount due with D's required installment is 100% of the required annual payment, computed as 100% divided by the number of required installments due for the short taxable year.

Example 7. E corporation is a calendar year taxpayer that computes its required installments based on 100 percent of the tax shown on the return for the taxable year in accordance with section 6655(d)(1)(B)(i). E computes its 2007 required installments based on a projected 2007 total tax liability of \$600,000. On July 31, 2007, E is acquired by F corporation resulting in E having a short taxable year from January 1, 2007, through July 31, 2007. E determines that its total tax liability for the short period is \$350,000. The due dates for E's first and second required installments are April 15, 2007, and June 15, 2007, respectively. However, because the due date for the first required installment falls on a weekend, E's first required installment payment will be timely if paid on or before the first business day following the actual due date of the required installment, that is, April 16, 2007. Pursuant to section 6655(d)(1)(A), E paid \$150,000 with each required installment. Pursuant to paragraph (c)(2) of this section, E's third (and last) required installment of estimated tax is due on September 15, 2007, and the percentage of the required annual

payment due with such installment is 100% pursuant to paragraph (d)(1) of this section. However, because the due date for the third (and last) required installment falls on a weekend, E's third (and last) required installment payment will be timely if paid on or before the first business day following the actual due date of the required installment, that is, September 17, 2007. Accordingly, E is required to pay \$50,000 with its final required installment on September 17, 2007 (\$350,000 total tax liability for the short taxable year less prior installment payments of \$300,000).

Example 8. Same facts as Example 7 except that E is acquired by F corporation on August 31, 2007. Pursuant to paragraph (c)(2)(ii) of this section, E's third (and last) required installment of estimated tax is due on October 15, 2007, because September 15, 2007, the date that would have been the due date of E's next required installment if F's acquisition of E had not occurred, is within thirty days of the last day of E's short taxable year, and 100% of the required annual payment is due with such installment.

Example 9. F corporation is a calendar year taxpayer that computes its required installments based on 100 percent of the tax shown on the return for the taxable year in accordance with section 6655(d)(1)(B)(i). F computes its 2007 estimated tax payments based on a projected 2007 total tax liability of \$900,000. On December 3, 2007, F is acquired by G corporation resulting in F having a short taxable year from January 1, 2007, through December 3, 2007. F determined its total tax liability for the short period to be \$800,000. The due dates for F's first, second, and third required installments are April 15, 2007, June 15, 2007, and September 15, 2007, respectively. However, because the due dates for the first and third required installments fall on a weekend, F's required installment payments will be timely if paid on or before the first business day following the actual due date of the required installments, that is, April 16, 2007, and September 17, 2007, respectively, for the first and third required installments. Pursuant to section 6655(d)(1)(A), F paid \$225,000 with each required installment. Pursuant to paragraph (c)(2)(ii) of this section, F's fourth (and last) required installment of estimated tax is due on February 15, 2008, and the percentage of the required annual payment due with such installment is 100% pursuant to paragraph (d)(1) of this section. Accordingly, F is required to pay \$125,000 with its final required installment due February 15, 2008 (\$800,000 total tax liability for the short taxable year less prior installment payments of \$675,000).

Example 10. G corporation, a calendar year taxpayer, reported a tax liability of \$75,000 on its return for the taxable year ending December 31, 2006, and is not a large corporation as defined in section 6655(g). On July 31, 2007, G makes a final distribution of its assets, in connection with a plan of complete liquidation, resulting in a short taxable year from January 1, 2007, through July 31, 2007. To satisfy the requirements of the exception described in section 6655(d)(1)(B)(ii) for payments determined by reference to the tax shown on the return of the corporation for the preceding taxable year, pursuant to paragraph (d)(2) of this section, G must pay in a proportionate amount of its 2006 tax liability based on the number of months in the current taxable year. Accordingly, G must pay \$43,750 ($\$75,000 \times 7/12$) through payments of estimated tax payments in 2007, with \$14,583 due on April 15, 2007, June 15, 2007, and September 15, 2007. However, because the due dates for the first and third required installments fall on a weekend, G's required installment payments will be timely if paid on or before the first business day following the actual due date of the required installments, that is, April 16, 2007, and September 17, 2007, respectively, for the first and third required installments.

Example 11. Same facts as Example 10 except that G makes a final distribution of its assets, in connection with a plan of complete liquidation, on October 1, 2007, resulting in a short taxable year from January 1, 2007, through October 1, 2007. To satisfy the requirements of the exception described in section 6655(d)(1)(B)(ii), G must pay \$56,250 ($\$75,000 \times 9/12$) through payments of estimated tax in 2007, with \$14,063 due on April 15, 2007, June 15, 2007, September 15, 2007, and December 15, 2007, respectively. However, because the due dates for the first, third, and fourth required installments fall on a weekend, G's required installment payments will be timely if paid on or before the first business day following the actual due date of the required installments, that is, April 16, 2007, September 17, 2007, and December 17, 2007, respectively, for the first, third, and fourth required installments.

Example 12. H corporation began business on February 15, 2007, and adopted a calendar year. H computes its required installments based on 100 percent of the tax shown on the return for the taxable year in accordance with section 6655(d)(1)(B)(i). H estimated at the beginning of its short taxable year that its estimated tax liability for short taxable year February 15, 2007, through December 31, 2007, would be \$180,000. H paid its first required installment

of estimated tax of \$60,000 on June 15, 2007, its second required installment of estimated tax of \$60,000 on September 17, 2007, and its third (and last) required installment of estimated tax of \$60,000 on December 17, 2007 (\$180,000 total estimated tax liability for the short taxable year less prior installment payments of \$120,000). H reported a tax liability of \$240,000 on its return for the short period February 15, 2007, through December 31, 2007, with no credits against tax. There was an underpayment in the amount of \$20,000 on the first installment date through September 15, 2007, \$40,000 on the second installment date through December 15, 2007, and \$60,000 on the third (and last) installment date through March 15, 2008, determined as follows:

(i) Tax as defined in section 6655(d)(1)(B)(i)	\$240,000
(ii) 100% of this paragraph (e), <u>Example 12</u> (i)	240,000
(iii) Amount of estimated tax required to be paid by the first installment date (33.33% of \$240,000)	80,000
(iv) Amount of estimated tax required to be paid by the second installment date (66.67% of \$240,000 less \$80,000 (amount due with first installment))	80,000
(v) Amount of estimated tax required to be paid by the third installment date (100% of \$240,000 less \$160,000 (amount due with first and second installment))	80,000
(vi) Deduct amount paid on or before the first installment date	60,000
(vii) Amount of underpayment for the first installment date (this paragraph (e), <u>Example 12</u> (iii) minus this paragraph (e), <u>Example 12</u> (vi))	20,000
(viii) Deduct amount available for the second installment date (\$60,000 second installment payment less this paragraph (e), <u>Example 12</u> (vii) applied towards the first installment underpayment)	40,000
(ix) Amount of underpayment for the second installment date (this paragraph (e), <u>Example 12</u> (iv) minus this paragraph (e), <u>Example 12</u> (viii))	40,000

(x) Deduct amount available for the third installment date (\$60,000 third installment payment less this paragraph (e), Example 12 (ix) applied towards the second installment underpayment) 20,000

(xi) Amount of underpayment for the third installment date (this paragraph (e), Example 12 (v) minus this paragraph (e), Example 12 (x)) 60,000

(f) 52 or 53 week taxable year. For purposes of this section a taxable year of 52 or 53 weeks shall be deemed a period of 12 months in the case of a corporation that computes its taxable income in accordance with the election permitted by section 441(f).

(g) Use of annualized income or seasonal installment method--

(1) In general. Regardless of the annual accounting period used by a corporation (for example, calendar year, fiscal year) the taxpayer may use the method described in §1.6655-2 (annualized income installment method) or §1.6655-3 (adjusted seasonal installment method) to compute its required installments of estimated tax when the current taxable year is a short taxable year.

(2) Computation of annualized income installment. To the extent a short taxable year includes an annualization period elected by the taxpayer, the taxpayer shall compute its annualized income installment by determining the tax on the basis of such annualized income for the annualization period multiplied by the number of months in the short taxable year divided by 12.

(3) Annualization period for final required installment. For

purposes of determining the final required installment (as described in paragraph (c)(2) of this section) for a short taxable year, annualized taxable income shall be determined by placing on an annualized basis the taxable income for the last complete annualization period that occurs within the short taxable year.

(4) Examples. The provisions of paragraph (g) of this section may be illustrated by the following examples:

Example 1. X corporation began business on February 12, 2007, and adopted a calendar year as its taxable year. X adopts an accrual method of accounting and uses the annualized income installment method under section 6655(e)(2)(A)(i) to calculate all of its required installment payments for its 2007 taxable year. Pursuant to §1.6655-1(f)(2)(i), the due dates of X's required installments for X's initial taxable year from February 12, 2007, through December 31, 2007, are April 15, 2007, June 15, 2007, September 15, 2007, and December 15, 2007. However, in accordance with paragraph (c)(1)(ii) of this section, X's first required installment is due June 15, 2007. As a result, X's second required installment is due September 15, 2007, and X's third (and last) required installment is due December 15, 2007. However, because the due dates for the third and fourth required installments fall on a weekend, X's required installment payments will be timely if paid on or before the first business day following the actual due date of the required installments, that is, September 17, 2007, and December 17, 2007, respectively, for the third and fourth required installments. The amount of X's first and second required installments are each based on annualizing X's taxable income from February 12, 2007, through April 30, 2007, (the first three months of X's taxable year) and X's third (and last) required installment is based on annualizing X's taxable income from February 12, 2007, through July 31, 2007 (the first six months of X's taxable year). Because X will have three required installments due for its short taxable year, pursuant to paragraph (d)(3)(ii) of this section, the applicable percentage is 33.33% for X's first required installment, 66.67% for X's second required installment, and 100% for X's third (and last) required installment.

Example 2. Y, a calendar year corporation, made a final

distribution of its assets, in connection with a plan of complete liquidation, on August 1, 2007. Y filed a timely election to use the alternative annualization periods described under section 6655(e)(2)(C)(i) and determined that its taxable income for the first 2, 4 and 7 months of the taxable year was \$25,000, \$50,000 and \$140,000. The due dates for Y's required installments for its short taxable year January 1, 2007, through August 1, 2007, are April 15, 2007, June 15, 2007, and September 15, 2007. However, because the due dates for the first and third required installments fall on a weekend, Y's required installment payments will be timely if paid on or before the first business day following the actual due date of the required installments, that is, April 16, 2007, and September 17, 2007, respectively, for the first and third required installments. Y made installment payments of \$10,000, \$10,000, and \$20,000, respectively, on April 16, 2007, June 15, 2007, and September 17, 2007. The taxable income for each period is annualized as follows:

$$\$25,000 \times 12/2 = \$150,000$$

$$\$50,000 \times 12/4 = \$150,000$$

$$\$140,000 \times 12/7 = \$240,000$$

(i)(A) To determine whether the first required installment equals or exceeds the amount that would have been required to have been paid if the estimated tax were equal to one hundred percent of the tax computed on the annualized income for the 2-month period taking into account the number of months in the short taxable year, the following computation is necessary:

(1) Annualized income for the 2 month period	\$150,000
(2) Tax on this paragraph (g)(4), <u>Example 2</u> (i)(A)(1)	39,250
(3) Tax determined under this paragraph (g)(4), <u>Example 2</u> (i)(A)(2) multiplied by 7 (the number of months in the short taxable year) divided by 12	22,896
(4) 100% of this paragraph (g)(4), <u>Example 2</u> (i)(A)(3)	22,896
(5) 33.33% of this paragraph (g)(4), <u>Example 2</u> (i)(A)(4)	7,631

(B) Because the total amount of estimated tax that is timely paid on or before the first installment date (\$10,000) exceeds the amount required to be paid on or before this date if the estimated tax were one hundred percent of the tax determined by placing on an annualized basis the taxable income for the first 2-month period taking into account the number of months in the short taxable year, the exception described in §1.6655-2(a) applies and no addition to tax will be imposed for the installment due on April 15, 2007.

(ii)(A) To determine whether the required installments made on or before June 15, 2007, equal or exceed the amount that would have been required to have been paid if the estimated tax were equal to one hundred percent of the tax computed on the annualized income for the 4-month period taking into account the number of months in the short taxable year, the following computation is necessary:

(1) Annualized income for the 4 month period	\$150,000
(2) Tax on this paragraph (g)(4), <u>Example 2</u> (ii)	
(A)(1)	39,250
(3) Tax determined under this paragraph (g)(4), <u>Example 2</u> (ii)(A)(2) multiplied by 7 (the number of months in the short taxable year) divided by 12	22,896
(4) 100% of this paragraph (g)(4), <u>Example 2</u> (ii)	
(A)(3)	22,896
(5) 66.67% of this paragraph (g)(4), <u>Example 2</u> (ii)	
(A)(4) less \$7,631 (amount due with first installment)	7,631

(B) Because the total amount of estimated tax available to apply towards the amount due for the second installment (\$12,369 (\$10,000 paid on the second installment date plus \$2,369 overpayment of the first installment)) exceeds the amount required to be paid on or before this date if the estimated tax were one hundred percent of the tax determined by placing on an annualized basis the taxable income for the first 4-month period for the taxable year taking into account the number of months in the short taxable year, the exception described in §1.6655-2(a) applies and no addition to tax will be imposed for the installment due on June 15, 2007.

(iii)(A) Pursuant to paragraph (c) and (d) of this section, the final required installment is due by September 15, 2007, and the applicable percentage due for the final required installment is

100%. However, because the due date for the final required installment falls on a weekend, Y's final required installment payment will be timely if paid on or before the first business day following the actual due date of the required installment, that is, September 17, 2007. To determine whether the installment payments made on or before September 17, 2007, equal or exceed the amount that would have been required to have been paid if the estimated tax were equal to one hundred percent of the tax computed on the annualized income for the 7-month period taking into account the number of months in the short taxable year, the following computation is necessary:

(1) Annualized income for the 7 month period	\$240,000
(2) Tax on this paragraph (g)(4), <u>Example 2</u> (iii)	
(A)(1)	56,100
(3) Tax determined under this paragraph (g)(4), <u>Example 2</u> (iii)(A)(2) multiplied by 7 (the number of months in the short taxable year) divided by 12	32,725
(4) 100% of this paragraph (g)(4), <u>Example 2</u> (iii)	
(A)(3)	32,725
(5) 100% of this paragraph (g)(4), <u>Example 2</u> (iii)	
(A)(4) less \$15,262 (amount due with first and second installment)	17,463

(B) Because the total amount of estimated tax available to apply towards the amount due for the final installment (\$24,738 (\$20,000 that is timely paid on the third installment date plus \$4,738 overpayment of the second installment)) exceeds the amount required to be paid on or before this date if the estimated tax were one hundred percent of the tax determined by placing on an annualized basis the taxable income for the first 7-month period for the taxable year taking into account the number of months in the short taxable year, the exception described in §1.6655-2(a) applies and no addition to tax will be imposed for the final installment due on September 15, 2007.

(h) Preceding taxable year a short taxable year. If the preceding taxable year referred to in section 6655(d)(1) was a short taxable year, the tax computed on the basis of the facts shown on

the return for such preceding year, for purposes of determining the applicability of the exception described in section 6655(d)(2), shall be the tax computed on the annual basis in the manner described in section 443(b)(1) (prior to the reduction of the tax liability in the manner described in the last sentence).

(i) Effective date. This section applies to taxable years beginning after the date that is 30 days after the date the final regulations are published in the **Federal Register**.

§1.6655-6 Methods of accounting.

(a) In general. In computing any required installment, a corporation must use the methods of accounting used in computing taxable income for the taxable year for which estimated tax is being determined (the current taxable year).

(b) Exceptions--(1) Automatic accounting method changes. If a taxpayer is making a change in method of accounting for the current taxable year that is permitted to be made with the automatic consent of the Commissioner, the new method of accounting shall be used in determining any required installment if, and only if, the copy of the Form 3115, "Application for Change in Accounting Method," has been mailed to the IRS National Office on or before the last day of the annualization period.

(2) Non-automatic accounting method changes. If a taxpayer is making a change in method of accounting for the current taxable year

that requires the prior consent of the Commissioner, the new method of accounting shall be used in determining any required installment if, and only if, the consent agreement reflecting the Commissioner's consent to the change in method of accounting and the prescribed terms and conditions for effecting such change has been signed by the taxpayer and mailed to the IRS National Office on or before the last day of the annualization period.

(c) Examples. The following examples illustrate the rules of this section:

Example 1. X corporation, a calendar year taxpayer, uses an accrual method of accounting and the annualization method under section 6655(e)(2)(A)(i) to calculate its 2006 required installments. X receives advance payments each taxable year with respect to agreements for the sale of goods properly includible in X's inventory. The advance payments received by X qualify for deferral under §1.451-5(c). Although X is eligible to defer the advance payments in accordance with §1.451-5(c), X's method of accounting with respect to the advance payments is to include the advance payments in income when received. If, as of the last day of the annualization period, X's method of accounting for advance payments is to include the advance payments in income when received, and the requirements of paragraph (b)(1) or (b)(2) of this section, as applicable, are not met, then X must use that method of accounting for purposes of computing such required installment.

Example 2. Y corporation, a calendar year taxpayer, uses an accrual method of accounting and the annualization method under section 6655(e)(2)(A)(i) to calculate its 2006 required installments. Y computes its annual taxable income by deducting its liability for state income taxes in the taxable year the taxes are paid, without regard to the recurring item exception of section 461(h) and the regulations. If, as of the last day of the annualization period, Y's method of accounting for state income taxes is to deduct such taxes in the taxable year the taxes are paid without regard to the recurring item exception, and the requirements of paragraph (b)(1) or (b)(2) of this section, as applicable, are

not met, then Y must use that method of accounting for purposes of computing such required installment.

(d) Effective date. This section applies to taxable years beginning after the date that is 30 days after the date the final regulations are published in the **Federal Register**.

Par. 12. Newly designated §1.6655-7 is revised to read as follows:

§1.6655-7 Addition to tax on account of excessive adjustment under section 6425.

(a) Section 6655(h) imposes an addition to the tax under chapter 1 of the Internal Revenue Code in the case of any excessive amount (as defined in paragraph (c) of this section) of an adjustment under section 6425 that is made before the 15th day of the third month following the close of a taxable year beginning after December 31, 1967. This addition to tax is imposed whether or not there was reasonable cause for an excessive adjustment.

(b) If the amount of an adjustment under section 6425 is excessive, there shall be added to the tax under chapter 1 of the Internal Revenue Code for the taxable year an amount determined at the annual rate referred to in the regulations under section 6621 upon the excessive amount from the date on which the credit is allowed or refund paid to the 15th day of the third month following the close of the taxable year. A refund is paid on the date it is

allowed under section 6407.

(c) The excessive amount is equal to the lesser of the amount of the adjustment or the amount by which--

(1) The income tax liability (as defined in section 6425(c)) for the taxable year, as shown on the return for the taxable year; exceeds

(2) The estimated income tax paid during the taxable year, reduced by the amount of the adjustment.

(d) The computation of the addition to the tax imposed by section 6425 is made independent of, and does not affect the computation of, any addition to the tax that a corporation may otherwise owe for an underpayment of an installment of estimated tax.

(e) The following example illustrates the rules of this section:

Example. (i) Corporation X, a calendar year taxpayer, had an underpayment as defined in section 6655(b), for its fourth installment of estimated tax that was due on December 15, 2006, in the amount of \$10,000. On January 2, 2007, X filed an application for adjustment of overpayment of estimated income tax for 2006 in the amount of \$20,000.

(ii) On February 16, 2007, the IRS, in response to the application, refunded \$20,000 to X. On March 15, 2007, X filed its 2006 tax return and made a payment in settlement of its total tax liability. Assuming that the addition to tax is computed under section 6621(a)(2) at a rate of 8% per annum for the applicable periods of underpayment, under section 6655(a), X is subject to an addition to tax in the amount of \$197 ($90/365 \times \$10,000 \times 8\%$) on account of X's December 15, 2006, underpayment. Under section

6655(h), X is subject to an addition to tax in the amount of \$118 ($27/365 \times \$20,000 \times 8\%$) on account of X's excessive adjustment under section 6425. In determining the amount of the addition to tax under section 6655(a) for failure to pay estimated income tax, the excessive adjustment under section 6425 is not taken into account.

(f) An adjustment is generally to be treated as a reduction of estimated income tax paid as of the date of the adjustment.

However, for purposes of §1.6655-1 through §1.6655-6, the adjustment is to be treated as if not made in determining whether there has been any underpayment of estimated income tax and, if there is an underpayment, the period during which the underpayment existed.

(g) This section applies to taxable years beginning after the date that is 30 days after the date the final regulations are published in the **Federal Register**.

PART 301--PROCEDURE AND ADMINISTRATION

Par. 13. The authority citation for part 301 continues to read, in part, as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 14. Section 301.6655-1 is revised to read as follows:

§301.6655-1 Failure by corporation to pay estimated income tax.

(a) For regulations under section 6655, see §§1.6655-1 through 1.6655-7 of this chapter.

(b) This section applies to taxable years beginning after the date that is 30 days after the date the final regulations are published in the **Federal Register**.

/s/ Mark E. Matthews

Deputy Commissioner for Services and Enforcement.