

Office of Chief Counsel
Internal Revenue Service
Memorandum

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to: Carol E. Schultze, Associate Area Counsel, LMSB
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from: Office of Associate Chief Counsel (IT&A)
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subject: Scope of Rev. Proc. 2002-18, 2002-1 C.B.678

This Chief Counsel Advice responds to your request for assistance. This advice may not be used or cited as precedent.

LEGEND

Taxpayer =

ISSUE

Whether the rejection of amended returns attempting to implement a retroactive change in method of accounting without the consent of the Commissioner under § 446(e) of the Internal Revenue Code brings the issue within the scope of Rev. Proc. 2002-18.

CONCLUSION

The rejection of amended returns attempting to implement a retroactive change in method of accounting without consent under § 446(e) does not bring the issue within the scope of Rev. Proc. 2002-18.

FACTS

Taxpayer creates securities by securitizing packages of
. In the process of creating these securities, Taxpayer states that it purchases

interest-only strips (“strips”) from the loan originators in order to conform to the requirements of the market for its securities.

Taxpayer’s federal income tax returns for the years are in Appeals. In its returns filed for those taxable years taxpayer did not utilize a prepayment assumption in its calculation of original issue discount (“OID”) for its strips.

In , Taxpayer filed with Appeals amended returns for the taxable years . Among other changes, these amended returns utilize a prepayment assumption to calculate OID for its strips. Taxpayer did not file a Form 3115 to request permission under § 446(e) to change its method of accounting for strips for the taxable years reflected in the amended returns. In its original returns filed for taxable years and taxpayer utilized the prepayment assumption to calculate OID for its strips. The taxpayer did not file a Form 3115 to change its method of accounting for strips for , and did not take into account an adjustment under § 481(a).

Jurisdiction over the claim was returned to Examination for further development. Examination determined that the change in prepayment assumption for the strips constituted a change in method of accounting under § 446(e) and could not be made on a retroactive basis in taxable years .

LAW AND ANALYSIS

Section 446(a) provides that taxable income shall be computed under the method of accounting on the basis of which the taxpayer regularly computes his income in keeping his books.

Section 446(b) provides that if no method of accounting has been regularly used by the taxpayer, or if the method used does not clearly reflect income, the computation of taxable income shall be made under such method as, in the opinion of the Secretary, does clearly reflect income.

Section 446(e) provides that, except as otherwise expressly provided, a taxpayer who changes the method of accounting on the basis of which he regularly computes his income in keeping his books shall, before computing his taxable income under the new method, secure the consent of the Secretary. Section 1.446-1(e)(2) of the Income Tax Regulations provides that such consent must be secured whether or not the method to be changed is proper or is permitted under the Internal Revenue Code or the regulations thereunder.

Section 1.446-1(c)(3)(i) provides that, except as otherwise provided in § 1.446-1(c)(3)(ii), a taxpayer seeking the consent of the Commissioner to change its

method of accounting must file an application on Form 3115 during the taxable year in which the taxpayer desires to change its method of accounting.

Section 1.446-1(c)(3)(ii) provides that the Commissioner may prescribe administrative procedures under which taxpayers will be permitted to change their method of accounting. The administrative procedures shall prescribe those terms and conditions necessary to obtain the Commissioner's consent to effect the change and to prevent amounts from being duplicated or omitted.

Section 446(e) and § 1.446-1(e)(3) preclude a taxpayer from making a retroactive change in method of accounting by amending prior tax returns without the consent of the Commissioner. Although the Commissioner is authorized to consent to a retroactive accounting method change, a taxpayer does not have a right to a retroactive change, regardless of whether the change is from a permissible or impermissible method. Rev. Rul. 90-38, 1990-1 C.B. 57; Rev. Proc. 2002-18 § 2.03.

Revenue Procedure 2002-18 provides the procedures under §§ 446(b) and 1.446-1(b) for the Service to resolve accounting method issues by the imposition of an accounting method change or other resolution. Specifically, § 4 of Rev. Proc. 2002-18 provides in relevant part that, except as otherwise provided in published guidance, the revenue procedure applies to any accounting method change imposed by the Service.

The question presented is whether the rejection of amended returns attempting to implement a retroactive accounting method change lacking consent under § 446(e) falls within the scope of Rev. Proc. 2002-18.

Examination concluded that the change in prepayment assumptions used to determine OID for the strips constituted a change in method of accounting under §446(e). Examination further concluded that this accounting method change would be improper because it would be made retroactively and without the consent required under § 446(e). Accordingly, Examination rejected the amended returns to the extent they reflected the change in prepayment assumption for the strips.

The actions of Examination do not fall within the scope of Rev. Proc. 2002-18 as defined in § 4 thereof. The rejection of the improper accounting method change proffered by taxpayer is not an "accounting method change imposed by the Service" because Examination imposed no accounting method change on taxpayer in the years for which the taxpayer filed the claims (i.e., amended returns).

Accordingly, we conclude that the rejection of amended returns attempting to implement a retroactive change in method of accounting without consent under § 446(e) does not bring the issue within the scope of Rev. Proc. 2002-18.

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS

This writing may contain privileged information. Any unauthorized disclosure of this writing may undermine our ability to protect the privileged information. If disclosure is determined to be necessary, please contact this office for our views.

Please call (202) 622-4930 if you have any further questions.