

## Internal Revenue Service

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Person To Contact:  
, ID No.

Telephone Number:

Refer Reply To:  
CC:ITA:7  
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Date:  
June 28, 2017

### Legend

Taxpayer	=	
<u>A</u>	=	
<u>B</u>	=	
<u>C</u>	=	
<u>D</u>	=	
<u>E</u>	=	
<u>F</u>	=	

Re: Request for Extension of Time to File a Form 3115 to Change Taxpayer's Method of Accounting to Comply with § 267

Dear :

This letter ruling responds to a letter dated February 6, 2017, and subsequent correspondence submitted by Taxpayer. Taxpayer is requesting an extension of time pursuant to §§ 301.9100-1 and 301.9100-3 of the Procedure and Administration Regulations to file a Form 3115, *Application for Change in Accounting Method*, for the earliest taxable year not closed by the statute of limitations to change its method of accounting to comply with § 267 of the Internal Revenue Code.

### FACTS

Taxpayer represents the facts are as follows:

A was the founder and owner of both Taxpayer and B. Taxpayer is an S corporation that uses an overall accrual method of accounting. B is an S corporation

that uses the overall cash receipts and disbursements method of accounting (the “cash method”).

B manufactures and sells C to Taxpayer. Taxpayer purchases this merchandise on credit. Taxpayer claims a deduction with respect to the purchase of this merchandise for federal income tax purposes upon the purchase from B. In contrast, since B is a cash method taxpayer, B does not recognize any corresponding taxable income for federal income tax purposes upon the sale of this merchandise to Taxpayer.

Taxpayer has determined that its method of accounting for purchases from B is impermissible because it is not in compliance with § 267. Accordingly, Taxpayer seeks to file a Form 3115 to change its method of accounting to comply with § 267 in the earliest open taxable year. In Taxpayer’s view, effecting the accounting method change in the earliest open taxable year is the correct approach because of the recent change in ownership of Taxpayer and B that was the result of the recent death of A in D. Specifically, Taxpayer argues that allowing it to change its accounting method in the earliest open taxable year is appropriate as it will result in the previous owner(s) of Taxpayer recognizing at least some, if not all, of the positive adjustment under § 481(a) (the “§ 481(a) adjustment”) that will arise when Taxpayer complies with § 267.

We held the conference of right on April 24, 2017. Taxpayer submitted post-conference material on its proposed method change in a letter dated May 19, 2017. On June 8, 2017, we advised Taxpayer’s authorized representative that we were adverse to the requested extension of time to file a Form 3115 for the earliest open taxable year. On June 19, 2017, Taxpayer’s authorized representative advised us that Taxpayer would like an adverse ruling.

#### RULING REQUESTED

Taxpayer requests an extension of time pursuant to §§ 301.9100-1 and 301.9100-3 to file a Form 3115 to change its method of accounting to comply with § 267 for the earliest taxable year not closed by the statute of limitations.

#### LAW AND ANALYSIS

Section 1.446-1(e)(3)(i) of the Income Tax Regulations provides that to secure the Commissioner’s consent to a taxpayer’s change in method of accounting the taxpayer generally must file an application on Form 3115, “Application for Change in Accounting Method,” with the Commissioner during the taxable year in which the taxpayer desires to make the change in method of accounting.

Currently, Rev. Proc. 2015-13, 2015-5 I.R.B. 419, provides the procedures by which a taxpayer may obtain consent to change certain accounting methods. A taxpayer complying with all the applicable provisions of this revenue procedure has

obtained the consent of the Commissioner to change its accounting method under § 446(e) and the Regulations thereunder.

Section 2.03(1) of Rev. Proc. 2015-13 provides that, unless specifically authorized by the Commissioner or by statute, a taxpayer may not change an established method of accounting by amending its prior federal income tax return(s). See Rev. Rul. 90-38, 1990-1 C.B. 57.

Section 2.05 of Rev. Proc. 2015-13 provides that, unless specifically authorized by the Commissioner or by statute, a taxpayer may not request, or otherwise make, a retroactive change in method of accounting. See *generally* Rev. Rul. 90-38.

Section 6.03(4)(b) of Proc. 2015-13 provides that, except in unusual and compelling circumstances or as provided in section 6.03(4)(a) of Rev. Proc. 2015-13 (the 6-month automatic extension for filing a Form 3115), a taxpayer is not eligible for an extension of time to file a Form 3115.

However, § 301.9100-1(c) provides that the Commissioner has discretion to grant a reasonable extension of time under the rules set forth in §§ 301.9100-2 and 301.9100-3 to make certain regulatory elections.

Sections 301.9100-1 through 301.9100-3 provide the standards the Commissioner will use to determine whether to grant an extension of time to make an election. Section 301.9100-2 provides automatic extensions of time for making certain elections. Section 301.9100-3 provides extensions of time for making elections that do not meet the requirements of § 301.9100-2.

Section 301.9100-3(a) provides that requests for an extension of time subject to § 301.9100-3 will be granted when the taxpayer provides evidence to establish to the satisfaction of the Commissioner that the taxpayer acted reasonably and in good faith and that the granting of the extension will not prejudice the interests of the Government.

Section 301.9100-3(c)(2) imposes special rules for accounting method regulatory elections such as the one in question. Section 301.9100-3(c)(2)(i) provides that the interests of the Government are deemed to be prejudiced except in unusual and compelling circumstances if the accounting method regulatory election for which an extension of time is requested is subject to the procedure described in § 1.446-1(e)(3)(i) (requiring the advance written consent of the Commissioner). Section 301.9100-3(c)(2)(ii) provides that the interests of the Government are deemed to be prejudiced except in unusual and compelling circumstances if the accounting method regulatory election for which the extension of time is requested requires a § 481(a) adjustment (or would require such an adjustment if the taxpayer changed to the method of accounting for which the extension is requested in a taxable year subsequent to the year in which the election should have been made).

It is in the interest of sound tax administration to generally preclude taxpayers from requesting, or otherwise making, a retroactive change in an adopted method of accounting, whether the change is from a permissible or impermissible method. T.D. 8742, 1998-1 C.B. 388, 389 (February 2, 1998). What are unusual and compelling circumstances must be decided on a case-by-case basis in light of all applicable facts and circumstances. *Id.* at 390.

Taxpayer seeks permission to file a Form 3115 to change its method of accounting to comply with § 267 in the earliest taxable year not closed by the statute of limitations. Taxpayer's Form 3115 is subject to the procedure described in § 1.446-1(e)(3)(i) and requires a § 481(a) adjustment. Thus, barring unusual and compelling circumstances, Taxpayer is not entitled to an extension of time under § 301.9100-3 because the Government's interests are deemed prejudiced by its late filing of the Form 3115.

Here, Taxpayer is most likely able to file an automatic change Form 3115 for its current taxable year to change its method of accounting to comply with § 267 or, if it does not qualify for an automatic change, it can still file a nonautomatic Form 3115. See section 13.01 (losses, expenses, and interest with respect to transactions between related taxpayers) of Rev. Proc. 2017-30, 2017-18 I.R.B. 1130, 1184. However, Taxpayer is not seeking to file its Form 3115 for the current taxable year. Instead, Taxpayer is attempting to file its Form 3115 to obtain a retroactive change in method of accounting. This retroactive change has not been specifically authorized by the Commissioner or by statute. See section 2.05 of Rev. Proc. 2015-13. In the Government's view, it is not in the interest of sound tax administration to permit taxpayers from requesting, or otherwise making, a retroactive change in a method of accounting, whether the change is from a permissible or impermissible method. See T.D. 8742, 1998-1 C.B. at 389. Further, in the instant case, because (1) the accounting method regulatory election for which an extension of time is requested is subject to the procedure described in § 1.446-1(e)(3)(i) and (2) the proposed change in accounting method requires a § 481(a) adjustment, the Government's interests are deemed prejudiced by the late filing of Taxpayer's Form 3115 unless Taxpayer demonstrates unusual and compelling circumstances. The desire of Taxpayer's current owner to shift the onus of an unfavorable § 481(a) adjustment to Taxpayer's previous owner(s) does not demonstrate unusual and compelling circumstances.

## CONCLUSION

Based on the facts and representations submitted, we conclude that Taxpayer has not satisfied the requirements for granting an extension of time to file a Form 3115 to change its method of accounting to comply with § 267 for the earliest taxable year not closed by the statute of limitations. Specifically, Taxpayer has failed to demonstrate

unusual and compelling circumstances and, accordingly, the Government's interests are deemed prejudiced.

Also, at the same time Taxpayer filed this request for an extension of time to file its Form 3115, Taxpayer: (1) filed a Form 3115 to change its accounting method to comply with § 267 for its E taxable year; and (2) filed amended returns for the E and E taxable years to implement this change. The Internal Revenue Service will not consider the filed Form 3115 as it does not satisfy the requirements of § 1.446-1(e)(3)(i) and Rev. Proc. 2015-13 and it is a nullity. Moreover, Taxpayer's filing of amended returns for the E and E taxable years constitutes an unauthorized retroactive change in method of accounting. See Rev. Rul. 90-38 (a taxpayer may not, without the Commissioner's consent, retroactively change from an erroneous to a permissible method of accounting by filing amended returns, even if the period for amending the return for the first year in which the erroneous method was used has not expired); and sections 2.03(1) and 2.05 of Rev. Proc. 2015-13, 2015-5 I.R.B. at 424-425. Taxpayer must withdraw these amended returns and return to its original tax filings.

The ruling contained in this letter ruling is based upon facts and representations submitted by Taxpayer with accompanying penalty of perjury statements executed by appropriate parties.

This letter ruling is directed only to Taxpayer, who requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

In accordance with the power of attorney, we are sending a copy of this letter to Taxpayer's authorized representatives. We are also sending a copy of this letter to the appropriate operating division director.

Sincerely,

Cheryl Oseekey

CHERYL OSEEKEY  
Senior Counsel, Branch 6  
Office of Associate Chief Counsel  
(Income Tax and Accounting)

Enclosures (2):  
copy of this letter  
copy for section 6110 purposes