How is Method of Accounting Changed

- General rule
  - Get Commissioner’s consent
  - See Rev. Proc. 2002-9 for automatic consent situations
    - Be sure to run through citator

Change in Overall Method

- Change from cash to accrual
- Change from accrual to cash
- Change from hybrid method to another method
- Change from cash or accrual to hybrid method
Change in Method for an Item

- Change in the treatment of any material item
  - Material item
    - Any item which involves the proper time for inclusion in income or taking of a deduction
    - Dollar amount of item is not relevant

NOT a Change in Method

- Correction of mathematical or posting errors
- Errors in the computation of tax liability
- Adjustment of any item which does not involve the proper time for income or deduction

Change Relating to Inventory

- Change in an overall plan or system of identifying or valuing inventory
- Change in the treatment of any material item used in the plan for identifying or valuing inventory items
How Does Taxpayer Change?

- File Form 3115
  - Get guidance from
    - Instructions to Form 3115
    - Rev. Procs. 97-27 and 2002-19

Terms and Conditions

- Commissioner may prescribe limitations, terms and conditions
  - The year the change may be made
  - Whether a sec. 481(a) adjustment or cut-off basis
  - The sec. 481(a) adjustment period

Section 481(a) Adjustment

- Adjustment required to prevent any-
  - Omission of income or deductions
  - Double inclusions of income or double deduction
Calculation of Sec. 481(a) Adjustment

• Year of change is accounted for on the new method
• Section 481(a) adjustment –
  • Prior year items which would
    • Never be taken into consideration
    • Be taken into consideration twice

Cash to Accrual Change

• All the receivables at the end of the prior year, less
• All the accounts payable at the end of the prior year

Accrual to Cash Change

• All items that would be counted twice
Amortization of Sec. 481(a) Adjustment

- Positive adjustment - Amortize it over four years
- Negative adjustment – Deduct it all in the year of change
- Short year is considered a full year
  - Positive adjustment spread over next four taxable years, not next 48 months

Cut-Off Method

- IRS may require use of Cut-off Method
  - Only items arising after change are accounted for under new method
  - Items arising before the change continue to be accounted for under the old method

Revenue Procedure 97-27

- Applies to taxpayers desiring to change a method of accounting
- There are some exceptions
LIFO Method

- Cut-off Method must be used

Procedures for Taxpayers Under Audit

- General Rule –
  - Taxpayer may not request a change in method

- 90 Day Window
  - May request change within first 90 days of year if under examination for 12 consecutive months
  - Issue Pending
    - See Section 2.03(1) of Rev. Proc. 2002-19
Procedures for Taxpayer Under Audit

- **120 Day Window**
  - Request can be filed within 120 days of end of audit even if another audit has begun

Procedures for Taxpayer Under Audit

- **Consent of the District Director**
  - Can file for change any time if District Director consents
  - Normally District Director will consent as long as method is not an issue in the audit

  Issue Pending – see sec. 2.03(1)(b) of Rev. Proc. 2002-19

Procedures for Taxpayer at Appeals Level

- **May file for change**
  - Must give copy of Form 3115 to Appeals Officer
  - Form 3115 must contain name and phone number of the appeals officer
  - Taxpayer should type “issue under consideration” on the Form 3115
Procedures for Taxpayer in Court

- Can request change
- Must provide copy of Form 3115 to attorney for the government
- Form 3115 must contain name and phone number of government attorney
- Type “Issue under consideration” on the Form 3115

Shortened Adjustment Periods

- De Minimus Rule
  - Can elect one year period if positive 481(a) adjustment is less than $25,000
  - Election must be made on the Form 3115

Accelerated Adjustment Period

- Ceasing to engage in the business
  - Remaining amount of sec. 481(a) adjustment must be taken into account when business ceases
User Fee

- There is a User Fee to file Form 3115
  - See Rev. Proc. 2003-1
  - Currently fee is $1,500
  - Check citator for current Rev. Proc.

Incomplete Form 3115

- Where Form 3115 is incomplete when filed –
  - Taxpayer has 21 days to provide additional information requested