Updates to Automatic Accounting Method Change Procedures


Effective Date

Rev. Proc. 2011-14 is effective for applications filed on or after January 10, 2011 for a year of change ending on or after April 30, 2010. The IRS will return to the taxpayer any application that is filed with the IRS National Office on or after January 10, 2011, for a year of change ending on or after April 30, 2010, if the application is not filed consistent with the guidance contained in Rev. Proc. 2011-14.

Rev. Proc. 2011-14 also applies for Forms 3115 that are filed under Rev. Proc. 97-27 (as amplified and modified) on or after January 10, 2011, for a year of change ending on or after January 10, 2011.

Transition Rules


Under these transition rules, an eligible taxpayer may choose to make the change pursuant to Rev. Proc. 2011-14. If the taxpayer chooses to convert the Form 3115 pursuant to Rev. Proc. 2011-14, the taxpayer must notify the IRS National Office before the later of (1) February 11, 2011, or (2) the issuance of either a letter ruling granting or denying consent for the change, or a letter closing the case. If timely notified, the IRS National Office will return the Form 3115 for necessary modifications so that the Form 3115 complies with the rules contained in Rev. Proc. 2011-14, and will refund the user fee submitted with the Form 3115.

A taxpayer may convert a returned Form 3115 by resubmitting it with the necessary modifications—along with a copy of the IRS National Office letter sent with the returned Form 3115—to the National Office or, if applicable, to the IRS Ogden office, by the earlier of (1) the 30th calendar day after the date of the IRS letter returning the Form 3115 to the taxpayer, or (2) the date the taxpayer is required to file the copy of the application under provisions of Rev. Proc. 2011-14.

General Procedure - Changes

Taxpayers who fall within the scope of the new procedure will continue to be automatically granted the consent of the IRS to change an accounting method described in the Appendix of the procedure. Further, taxpayers under
examination can continue to file an application (Form 3115) to change accounting methods under the automatic consent procedures, but only during certain time periods or under certain conditions. Of significance, Rev. Proc 2011-14 modifies and clarifies Rev. Proc. 2008-52 when a taxpayer is under examination as follows (see Rev. Proc. 2011-14, Sections 3.08 and 3.09, and 6.03 and 6.04):

- Modify the 120-day window period to provide if a taxpayer is within the 120-day window period, that 120-day window period ends when IRS Appeals refers a case to the examining agent(s) for reconsideration
- Clarify that a taxpayer under examination, for purposes of Rev. Proc. 2011-14, continues to be under examination while the taxpayer has a refund or credit under review by the Joint Committee on Taxation (JCT), and establish when such an examination ends for purposes of Rev. Proc. 2011-14
- Modify the rules for a taxpayer with a method of accounting for an item that is an issue under consideration before an IRS Appeals Office when Appeals submits a refund or credit to the JCT
- Modify the rules for a taxpayer with a method of accounting for an item that is an issue under consideration before a federal court when a settlement stipulation is submitted to the JCT
- Provide that a taxpayer not otherwise within the scope of Rev. Proc. 2011-14 by reason of being under examination, a consolidated group member, or a partnership and S corporation that is before Appeals or a federal court with respect to any income tax issue may request a change in method of accounting without audit protection if the method to be changed is an issue under consideration by Appeals or the federal court

Additional procedural changes by Rev. Proc. 2011-14 that either modifies, clarifies, and/or supersedes Rev. Proc 2008-52 (as amplified or modified by Rev. Proc. 2009-39) includes

- Provide additional terms and conditions applicable to a foreign division of a domestic corporation taxpayer and foreign partnership, respectively
- Clarify the filing requirements of Rev. Proc. 2011-14 by consolidating the filing requirements into a single Section
- Require, in certain cases, a copy of the application be provided to the IRS in Ogden, UT (Ogden copy), in lieu of providing the copy of the application to the IRS National Office

Rev Proc 2011-14 Appendix   - New Automatic Method Changes

In addition to several of the procedural changes noted above, Rev. Proc. 2011-14 provides three additional automatic accounting method changes, described in more detail below, as follows:

1) Rev. Proc. 2011-14, Appendix Section 8.04 – Code Section 179D

Prior to the issuance of this Revenue Procedure, the interpretive guidance under the 2005 Energy Policy Act required taxpayers desiring to claim Section 179D deductions for qualifying energy efficient commercial buildings placed in service in prior years to amend their tax returns for those prior years (assuming the statute of limitations had not closed on those prior years’ tax filings).

Now, under Rev Proc 2011-14, Section 8.04, taxpayers may, in general, request an automatic method change to deduct, under Section 179D, amounts paid or incurred for installation of energy-efficient commercial building property. The deduction for energy efficient commercial building property must be claimed in the taxable year in which the property is placed in service and is subject to the limits of Section 179D(b). Further, the basis of the energy efficient commercial building property is reduced by the amount of the Section 179D deduction taken and the remaining basis of the energy efficient commercial building property is depreciated over its recovery period. This, in effect, allows for the true up between the Section 179D deduction and depreciation expense through a net Section 481(a) adjustment versus having to file amended returns. Please refer to Section 8.04(2)-(4) for specific filing requirements including the necessary certification statement(s) that must accompany the Form 3115 filing.
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The Internal Revenue Service’s approach as to how taxpayers will claim Section 179D deductions post the issuance of this Rev. Proc. is unique. The IRS, without providing any further written guidance at this point, has verbally communicated that taxpayers may have, based on their respective facts and circumstances, the following two options: either amend prior years’ tax returns, subject to statute of limitation issues, to claim qualifying Section 179D deductions for properties placed in service in those prior years, or file for an accounting method change, under Section 8.04 of this Rev. Proc, to claim a cumulative adjustment for qualifying Section 179D deductions in the year in which the change of accounting method is applicable. The “facts and circumstances”, to which the IRS refers for purposes of determining when a taxpayer should (or may be required to) use one option versus the other, is extremely vague. Per the IRS, taxpayers may use differing approaches depending on their unique tax posture.

The above is best illustrated through the use of a couple of examples.

**Example 1:**

Let’s assume the following facts: Taxpayer, a calendar year-end “C” corporation, has been extremely profitable during the tax years 2006-2009 and has paid significant tax liabilities in each year throughout that period. Also, Taxpayer has generated a tax liability for the 2010 year in the amount of $4 million. Taxpayer has now determined that qualifying Section 179D deductions exist in the amount of $2 million per year for the period 2006-2010 (or $10 million in the aggregate). Taxpayer’s tax rate is 35% in each of those years.

**Analysis:**

Prior to the issuance of Rev. Proc. 2011-14, Taxpayer would have been required to amend tax returns to claim the qualifying Section 179D deductions for only those years still open under the statute of limitations ($6 million total for 2007-2009 tax years). Thus, the $2 million of deductions that related to the 2006 year is permanently lost since the statute is already closed. Further, if Taxpayer’s 2007 corporate return was filed by the original due date of 3/15/08, that statute of limitation period will close effective 3/15/2011, which may result in another $2 million of qualifying Section 179D deductions being permanently lost related to 2007 year if Taxpayer cannot amend the return by then.

Under the new Rev. Proc, however, Taxpayer could now claim a cumulative Section 481(a) adjustment via filing a Form 3115 requesting an automatic method change in the 2010 tax year (assuming that return has not yet been filed by the original or extended due date), and claim a cumulative Section 179D deduction of $8 million (years 2006-2009). By filing Form 3115, Taxpayer effectively recoups qualifying Section 179D deductions for the 2006 tax year (e.g. the first year in which the Section 179D deductions became available pursuant to the Energy Policy Act) since the statute of limitations would not apply for a method change request requiring a Section 481(a) adjustment.

Therefore, the cumulative Section 481(a) adjustment of $8 million, coupled with the $2 million of Section 179D deductions for the 2010 year, will result in a $3.5 million reduction to Taxpayer’s 2010 tax liability ($10,000,000 Section 179D deduction in aggregate * 35% tax rate). Taxpayer recognizes the full tax benefit of the cumulative Section 179D deductions without having to amend tax returns for prior years.

Note that if Taxpayers’ anticipated tax liability for 2010 (before consideration of any cumulative Section 179D deductions) was only $3 million, the additional Section 179D deductions would have resulted in a $500,000 net operating loss for the 2010 tax year, which net operating loss could be used either for a carryback claim or carryforward to offset future taxable income.

The above example illustrates the benefits of the cumulative Section 481(a) adjustment for change in accounting method versus amending corporate tax returns when Taxpayer’s fact pattern is straightforward. However, rarely is that the case as demonstrated under the next example.

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Example 2:

Let’s assume the following facts: Taxpayer, a calendar year “C” corporation, generated $5 million of taxable income during the tax years 2005-2009 and paid tax liabilities in the amount of $1.75 million in each of those same years.

Taxpayer has now determined that qualifying Section 179D deductions exist in the amount of $5 million per year for the period 2006-2010 (or $25 million in the aggregate). However, Taxpayer is expecting a taxable loss for 2010 in the amount of $7 million, which is inclusive of the $5 million Section 179D deduction for that year. Taxpayer’s federal tax rate is 35% in each of those years.

Analysis:

Prior to the issuance of Rev. Proc. 2011-14, Taxpayer would have been required to amend tax returns to claim the qualifying Section 179D deductions for only those years still open under the statute of limitations ($15 million total 179D deductions for 2007-2009 tax years). Thus, the $5 million of deductions that related to the 2006 year is permanently lost since the statute is already closed. Further, if Taxpayer’s 2007 corporate return was filed by the original due date of 3/15/08, that statute of limitation period will close effective 3/15/2011, which may result in another $5 million of qualifying Section 179D deductions being permanently lost related to 2007 year if Taxpayer cannot amend the return by then.

Under the new Rev. Proc, however, Taxpayer could now claim a cumulative Section 481(a) adjustment via filing a Form 3115 requesting an automatic method change in the 2010 tax year (assuming that return has not yet been filed by the original or extended due date), and claim a cumulative Section 179D deduction of $20 million (years 2006-2009). As in example #1 above, Taxpayer effectively recoups qualifying Section 179D deductions for the 2006 tax year.

However, by accelerating the entire amount of the cumulative Section 179D deductions for periods 2006-2009 into the 2010 year via an accounting method change will only result in a $20 million increase to the 2010 net operating loss. Therefore, the net operating loss for the 2010 year will be $27 million ($7 million current year loss plus $20 million 481(a) adjustment). As such, under the carryback rules, Taxpayer could only carryback $10 million of the NOL ($5 million to 2008 and 2009 respectively) resulting in a current cash taxes refund claim of $3.5 million ($1.75 million taxes paid for 2008 and 2009 year). The remaining amount of the 2010 net operating loss ($17 million) simply carries forward to offset future taxable income.

Under the amended tax return approach, however, the client could amend each of the years' 2007-2009 to fully offset the taxable income in those years, thus generating a larger current cash tax refund in the amount of $5.25 million (refund claim for $1.75 million tax paid per year). The client is able to generate an additional $1.75 million of cash tax refund currently under the amended tax return scenario.

This amended return option would be further advantageous in the situation where an amended 2007 return for Section 179D deductions results in a net operating loss for that year, thus allowing Taxpayer the potential benefit of carrying back that loss two years (2005-2006) to recapture taxes paid in those years. That same benefit would not have been available under an accounting method change since any 2010 NOL could not be carried back past 2008.

The determination of whether to amend returns to claim Section 179D deductions versus claiming Section 179D deductions via a Section 481(a) adjustment under an accounting method change can be quite complex with careful consideration required of varying factors such as statute of limitations, carryback opportunities, etc.
Although the above discussion centered on Taxpayers that directly own the property to which the Section 179D deductions relate, the IRS has communicated that they acquiesce to that same treatment for Taxpayers meeting the qualification of “design” firm to whom Section 179D deductions may be allocated. In fact, the specific language within Section 8.04 of the Rev Proc. clearly states that the automatic method change applies to design firms.

However, when this new Section 8.04 is viewed in the context and totality of the entire Revenue Procedure, one could arrive at a different conclusion, which is that the automatic method change procedure does not apply to design firms since the transferred Section 179D deduction is not considered a method of accounting because there is no depreciation (the design firm does not own and depreciate the building) nor is the deduction a timing item but rather akin to a permanent deduction. It appears that the IRS will not apply that argument in favor of treating design firms in the same position as other taxpayers.

Due to the IRS’ statement that wide latitude will be granted taxpayers for choosing either amended returns or a Section 481(a) adjustment via accounting method change, or possibly choosing both depending on the tax years in question, each taxpayer should examine it facts and circumstances to better understand the impact of these options, and choose the most tax-advantageous option(s) until further guidance is forthcoming from the IRS or Treasury.

2) Rev. Proc. 2011-14, Section 15.11 – Advance Payments

This change applies to a taxpayer that: (A) receives advance payments, as defined in Rev. Proc. 2004-34, 2004-1 C.B. 991, (B) uses the deferral method described in Section 5.02(3)(a) of Rev. Proc. 2004-34 for including those advance payments in gross income in accordance with its applicable financial statement (AFS), (C) changes the manner in which it recognizes advance payments in revenues in its AFS, and (D) wants to change its method of accounting to use its new method of recognizing advance payments in revenues in its AFS for determining the extent to which advance payments are included in gross income under Rev. Proc. 2004-34.

A taxpayer's restatement of its AFS for financial accounting presentation does not affect the propriety of the taxpayer's method of accounting for advance payments in the prior taxable year(s). Thus, if the taxpayer uses the deferral method described in Section 5.02(3)(a) of Rev. Proc. 2004-34 for including advance payments in gross income in accordance with its AFS (even if the AFS for that taxable year is later restated), the taxpayer satisfies the requirement of paragraph (ii) in Section 15.11(a), and may change its method of accounting under that Subsection if it is otherwise eligible.

This change is made on a cut-off basis and applies only to advance payments received on or after the beginning of the year of change. Any advance payments received prior to the year of change are accounted for under the taxpayer's former method of accounting (i.e., according to its former AFS). Accordingly, a §481(a) adjustment is neither permitted nor required.

Generally, under § 446(e), a taxpayer that changes its book method of accounting must secure the Commissioner’s consent before applying its new book method of accounting for tax purposes. See also §1.446-1(e)(2)(i). Accordingly, a taxpayer that previously elected to defer advance payments under Rev. Proc. 2004-34 is required to obtain consent under §446(e) if the taxpayer subsequently changes its book method for the deferred advance payments and wants to use its new AFS in determining the extent to which advance payments are included in gross income under Rev. Proc. 2004-34.

Thus, the IRS provided for a “safe harbor” under Section 15.11(4)(c) of this Appendix to reduce controversy in this area. Basically, it states that if a taxpayer followed the applicable provisions of this Section 15.11 with respect to a change in method for advance payments (under the deferral method in accordance with Rev. Proc. 2004-34), and reflected such change on a timely filed original federal income tax return, then the IRS will not assert that the taxpayer’s present method of accounting for advance payments is not a proper deferral method described in Section

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5.02(3)(a) of Rev. Proc. 2004-34 solely on the ground that the taxpayer failed to obtain the consent of the Commissioner for that change.

Please note that while Section 15.11 of this Appendix does allow for a statement in lieu of filing Form 3115, Dixon Hughes recommends requesting such change in accounting method under this Section 15.11 via filing Form 3115 to ensure proper documentation for the change request.

3) Rev. Proc. 2011-14, Section 19.09 – California Franchise Taxes

This change applies to a taxpayer that wants to change its method of accounting for California franchise taxes to a method consistent with the holding in Rev. Rul. 2003-90, 2003-2 C.B. 353. Rev. Rul. 2003-90 provides that for taxable years beginning on or after January 1, 2000, a taxpayer that uses an accrual method of accounting incurs a liability for California franchise tax for federal income tax purposes in the taxable year following the taxable year in which the California franchise tax is incurred under the Cal. Rev. & Tax Code, as amended.

Rev. Proc. 2011-14: Other Changes to Appendix

Other changes made to the appendix, as contained in Rev. Proc. 2011-14 include, but not limited to, the following:

- Clarify that a taxpayer must compute a Section 481(a) adjustment when changing from a LIFO method to a non-LIFO method (see Appendix Section 22.01(7)). The IRS also provided a special rule for calculating the Section 481(a) adjustment when the taxpayer is changing to an inventory method that a taxpayer not using a LIFO method implements on a cut-off basis.
- Concerning changes for repair and maintenance costs—that modify the date that the additional Ogden copy of the application must be filed (see Section 3.06(3)).
- Relating to changes from impermissible to permissible methods of accounting for depreciation and amortization—that clarify that the amount of depreciation allowable takes into account all additional first year depreciation deduction provisions (Section 6.01)
- Relating to changes for dispositions of structural components of a building and relating to changes for dispositions of tangible depreciable assets (other than a building or its structural components)—that an additional statement to be provided when making the change in method of accounting (see Section 6.24 and 6.25)
- Method changes that require a copy of the Form 3115 be filed with the IRS in Ogden, UT, in lieu of providing a copy to both the IRS National Office and the Ogden office (see Section 6.02(3)

Consistent with the IRS’ administrative practice, other Sections within the Appendix of Rev. Proc. 2011-14 are modified to permit concurrent changes on a single Form 3115 when a taxpayer makes a change for more than one asset for the same year of change, and to provide rules for aggregation of the net Section 481(a) adjustments, including:

- Relating to changes from impermissible to permissible methods of accounting for depreciation or amortization (Appendix Section 6.01)
- Relating to changes for modern golf course greens (Appendix Section 6.04)
- Relating to changes for original and replacement tire costs (Appendix Section 6.05)
- Relating to changes in depreciation of gas pump canopies (Appendix Section 6.06)
- Relating to a change in depreciation of utility assets (Appendix Section 6.07)
- Relating to a change in depreciation of cable TV fiber optics (Appendix Section 6.08)
- Relating to a change in method of accounting for depreciation due to a change in the use of MACRS property (Appendix Section 6.10)
- Relating to a change in depreciation of qualified non-personal use vans and light trucks (Appendix Section 6.11)
- Relating to a change in depreciation of qualified revitalization building in the expanded area of a renewal community (Appendix Section 6.12)
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- Relating to a change in depreciation of MACRS property acquired in a like-kind exchange or as a result of an involuntary conversion (Appendix Section 6.18)

Relating to changes in Kansas additional first-year depreciation (Appendix Section 6.22); Rev. Proc. 2011-14 also notes that for certain of these items (listed above), taxpayers are permitted to make concurrent changes in method of accounting on a single Form 3115.

Lastly, Rev. Proc. 2011-14 contains a list of certain provisions that are removed because they are obsolete in whole or in part (See Section 16 of Rev. Proc. 2011-14 for listing).

For further information, please contact your Dixon Hughes tax advisor or Joyce Waterbury at jwaterbury@dixon-hughes.com.

About Dixon Hughes: With more than 1200 personnel located in nine states, Dixon Hughes PLLC provides a wide array of assurance, tax and consulting services to clients of all sizes. The company recently announced that effective April 1, 2011, it will merge with Virginia-based Goodman & Company, LLP. The combined firm will be known as Dixon Hughes Goodman LLP and will be headquartered in Charlotte, N.C. With more than 1,700 people in 30 offices in 11 states and Washington, D.C., Dixon Hughes Goodman will be the largest certified public accounting firm based in the Southern U.S. and the 13th largest in the nation. Visit www.dixon-hughes.com/dhg for more information.