AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

COMMENTS ON MODIFICATIONS TO REVENUE PROCEDURES 97-27 AND 2002-9

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BACKGROUND

Section 446(e) and the regulations thereunder require that a taxpayer who changes the method of accounting on the basis of which he regularly computes his income in keeping his books must, before computing his taxable income under the new method, secure the consent of the Commissioner. A taxpayer must file a Form 3115 to secure the Commissioner's consent to change a method of accounting.[1] For certain prescribed "automatic" accounting method changes, a taxpayer complying with all the applicable provisions of Rev. Proc. 2002-9 has obtained the consent of the Commissioner to change its method of accounting under section 446(e) and the regulations thereunder.[2] To obtain the consent of the Commissioner for "non-automatic" method changes that are not eligible for automatic consent, a taxpayer must follow the rules outlined in Rev. Proc. 97-27.

On December 6, 2005, the IRS issued Notice 2005-97 asking for comments on possible changes to the automatic method change procedures contained in Rev. Proc. 2002-9 as part of its plan to update Rev. Proc. 2002-9 to consolidate subsequently issued guidance. In this Notice, the IRS specifically requested comments with respect to the following issues:

1. Should any accounting method changes that are currently ineligible for automatic consent be made eligible for automatic consent?
2. Should any accounting method changes that are currently eligible for automatic consent be made ineligible for automatic consent?
3. Should modifications be made to any aspect (such as to the description or scope) of the accounting method changes currently eligible for automatic consent?
4. Should any modifications be made to the general procedures applicable to all automatic accounting method changes?

The AICPA previously provided comments on the method change consent procedures to the IRS and Treasury in letters dated March 30, 2007 and January 31, 2008. In those letters, we indicated our intent to submit additional comments addressing suggested modifications to the procedural rules applicable both to automatic and non-automatic method changes, including suggested changes to clarify the definition of "under examination" and modify the "window periods" applicable for taxpayers under examination. We believe that these proposed modifications are relevant whether or not the IRS overhauls the method change procedures as contemplated in Notice 2007-88, and will assist the IRS and Treasury in achieving their goals of encouraging prompt voluntary compliance and promoting the public interest.

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[1] Treas. Reg. section 1.446-1(e)(3)(i). The Commissioner may prescribe administrative procedures for a taxpayer to change its method not withstanding paragraph (e)(3)(i) of this provision.

[2] Rev. Proc. 2002-9, Section 1.

MODIFICATIONS TO THE PROCEDURAL RULES FOR BOTH AUTOMATIC AND NON-AUTOMATIC METHOD CHANGES

A. Expand rules to permit taxpayers to file a Form 3115 to change from an erroneous method that has been used for only one tax year.

Sections 2.01 of Rev. Proc. 97-27 and Rev. Proc. 2002-9 generally provide that an impermissible method of accounting must be used on two or more consecutively filed federal income tax returns in order for the taxpayer to be considered to have adopted a method of accounting for the item. *See* Rev. Rul. 90-38. The AICPA recommends that the IRS expand Rev. Proc. 97-27 and Rev. Proc. 2002-9 to permit taxpayers, at the taxpayers' option, to file a Form 3115, *Application for Change in Accounting Method*, to change from an erroneous method that has been used for only one tax year.

Under the current regime, a taxpayer that inadvertently uses an impermissible method of accounting on the first return for which the taxpayer accounted for the item must either: (1) continue to use the impermissible method for a second year and then file the change in method of accounting request for the third year, or (2) amend the first year return to reflect use of a correct method and file the second year return consistent with the amended return. Amending returns is a significant undertaking, particularly in the context of pass-though entities (e.g., partnership, S corporation) or taxpayers operating in multiple jurisdictions. In the case of pass-through entities, all of the owners' returns must be amended. Moreover, the filing of an amended federal income tax return may trigger the requirement to file amended state and local tax returns in dozens of jurisdictions. It is often impractical to amend multiple partners/shareholders and/or state/local tax returns. Thus, the current rules operate as a disincentive to compliance by encouraging taxpayers to remain on the impermissible method for a second year.

Allowing a taxpayer to correct an impermissible method used only once through the method change procedures would support the IRS goal of taxpayer compliance with permissible methods, encourage earlier taxpayer compliance, and reduce the taxpayer's compliance burden (by not requiring the filing of amended returns in order to cease use of the impermissible method as a taxpayer is currently required to amend its return). We note that a similar provision is already provided in Rev. Proc. 2007-16, which allows a taxpayer who used an impermissible depreciation method only on one tax return to either amend its tax return or file a Form 3115.

The AICPA believes that this revision will further encourage compliance with proper tax accounting methods. We recommend that changes filed for the second year be accorded the same terms and conditions as changes filed in the third, or subsequent years (e.g., a four year spread of positive section 481(a) adjustments). We believe that it is highly unlikely that a taxpayer would intentionally file the first return using an impermissible method, planning to change on the second year return with a four year spread of the section 481(a) adjustment. However, if the IRS were concerned about this possibility, it could require that in the case of a change from an impermissible method filed in the year following adoption, any section 481(a) adjustment must be accounted for in the year of change.

B. Clarify that all accounting method changes are implemented with a section 481(a) adjustment unless otherwise specifically stated.

1. The AICPA recommends that the IRS clarify Section 2.05 of Rev. Proc. 97-27 and Section 5.03 of Rev. Proc. 2002-9 to specifically state that all method changes are implemented with a section 481(a) adjustment, unless otherwise specifically stated.

   Ambiguity, and inconsistency in administration, as to whether an accounting method change is required to be implemented using the cut-off method or with a section 481(a) adjustment has created unnecessary uncertainty for a taxpayer seeking to file a Form 3115. For example, there has been controversy regarding what constitutes a change within the LIFO inventory method that must be implemented using a cut-off method under Section 5.02(3)(b) of Rev. Proc. 97-27. The AICPA believes that additional clarification to Rev. Proc. 97-27 and Rev. Proc. 2002-9 will further encourage taxpayers to voluntarily comply with proper tax accounting methods, facilitate the IRS' processing of method change requests, and provide taxpayers and examining agents with clearer and more consistent guidance.

   Certain accounting method changes governed by Rev. Proc. 2002-9 provide that the change is implemented on a cut-off basis (e.g., a change to/from or related to *de minimis* original issue discount (OID) under Section 12.01 of the Appendix to Rev. Proc. 2002-9); however, it is not always clear whether another change involving a similar issue (e.g., OID) would also be implemented on a cut-off basis or require the taxpayer to compute a section 481(a) adjustment. The AICPA recommends that the IRS clarify that method changes will be made with a section 481(a) adjustment unless the IRS has published guidance identifying that method as a method to be implemented on a cut-off basis. We also recommend that the IRS clarify that changes deemed to be "similar" to these changes continue to be made with a section 481(a) adjustment until such time as the "similar" change is identified as a change to be made on a cut-off basis in published guidance. The AICPA believes that this revision will further encourage compliance with proper tax accounting methods and provide for more certainty, consistency, and transparency in the processing of Forms 3115.

C. Clarify the definition of "under examination."

Section 3.07 of Rev. Proc. 97-27 and Section 3.08 of Rev. Proc. 2002-9 provide helpful explanations of when an IRS examination is considered to end; however, the revenue procedures do not cover some fairly common situations, such as those outlined below, that affect a taxpayer's ability to determine whether it is considered to be under examination.

1. The AICPA recommends that the IRS clarify that a taxpayer in the Compliance Assurance Process (CAP) is not considered to be under examination for purposes of filing the Form 3115 because tax practitioners have received conflicting answers on this issue from the IRS national office.

Since Announcement 2005-87 provides that the CAP is not subject to the restrictions of opening an examination contained in section 7605(b), the implication is that the CAP taxpayer is not considered to be under examination. Furthermore, the standard CAP Memorandum of Understanding provides that participation in the pre-filing CAP by the IRS does not constitute an examination or inspection of the taxpayer's books of account for purposes of section 7605(b). Nevertheless, it is not entirely clear whether a taxpayer in the CAP is under examination for purposes of filing the Form 3115. The AICPA believes that clarifying that a taxpayer in the CAP is not considered to be under examination will further encourage taxpayers to voluntarily comply with proper tax accounting methods, facilitate the IRS' processing of method change requests, provide taxpayers with more clear and consistent guidance, as well as assist taxpayers in complying with Financial Accounting Standards Board (FASB) Interpretation No. 48 (FIN 48), "Accounting for Uncertainty in Income Taxes."

The AICPA believes that it is reasonable to conclude that a taxpayer in the CAP is not under examination because the IRS is not raising issues with regard to filed returns. However, taxpayers simply need clarity so they can determine whether they are eligible to file a Form 3115.

2. Also, the AICPA recommends that the IRS clarify whether a taxpayer is considered to be under examination when proposed adjustments have been forwarded to the Joint Committee on Taxation (JCT) for review. Under the general rules of Rev. Procs. 2002-9 and 97-27, an examination ends when:

   a. in a case in which the Service accepts the return as filed, on the date of the "no change" letter sent to the taxpayer;

   b. in a fully agreed case, on the earliest of the date the taxpayer executes a waiver of restrictions on assessment or acceptance of overassessment (for example, Forms 870, 4549, or 4605), the date the taxpayer makes a payment of tax that equals or exceeds the proposed deficiency, or the date of the "closing" letter (for example, Letter 891 or 987) sent to the taxpayer; or

   c. in an unagreed or a partially agreed case, on the earliest of the date the taxpayer (or its representative) is notified by Appeals that the case has been referred to Appeals from Examination, the date the taxpayer files a petition in the Tax Court, the date on which the period for filing a petition with the Tax Court expires, or the date of the notice of claim disallowance.[3]

   One of these actions must occur before a case is forwarded to the Joint Committee on Taxation. However, Rev. Proc. 2005-32 states that a "case involving a refund or credit in excess of the statutory sum that is subject to review by the [JCT], pursuant to section 6405, is not a closed case until Joint Committee review procedures and any necessary follow-up are complete." This statement could imply that a taxpayer's refund claim that is under

[3] Rev. Proc. 97-27.

review by the JCT is under examination. However, members of the AICPA have received informal oral guidance from the IRS national office indicating that a taxpayer in such circumstances is not considered to be under examination. The AICPA believes that a JCT review should be considered as similar to an appeals review, and thus an accounting method change request should be permitted unless the issue is under consideration by JCT.

Therefore, a reasonable solution would be to treat taxpayers under JCT review similarly to taxpayers that are before appeals or federal court. Such a taxpayer would still be able to file a Form 3115, provided the taxpayer is not changing the same method to which the JCT review relates. The taxpayer should simply use a checked box similar to line 5c of the current Form 3115 (revised December 2003) to indicate that the taxpayer is not changing the same method to which such refund or credit relates.

3. As noted above, Rev. Procs. 2002-9 and 97-27 provide the general rules for when a taxpayer is under examination. Absent from this definition is when a controlled foreign corporation (CFC) or other foreign corporation for which Form 5471, *Information Return of U.S. Persons With Respect to Certain Foreign Corporations*, must be filed is considered to be under examination. The AICPA recommends that the IRS clarify when these foreign corporations are considered to be under examination.

   The AICPA recommends that the IRS clarify that a CFC or any other foreign corporation for which Form 5471 must be filed is considered to be under examination when a U.S. shareholder that includes the foreign corporation's Form 5471 in its federal income tax return is under examination. This rule is consistent with informal advice given by the IRS national office, and is similar to the current rules applicable to partnerships and S corporations.

D. Clarify the definition of "issue under consideration."

The AICPA recommends that the IRS clarify Section 3.08(1) of Rev. Proc. 97-27 and Section 3.09(1) of Rev. Proc. 2002-9, which provide that a taxpayer's method of accounting for an item is an issue under consideration for the tax years under examination if the taxpayer receives written notification (for example, by examination plan, information document request (IDR)), or notification of proposed adjustments or income tax examination changes) from the examining agent(s) specifically citing the treatment of the item as an issue under consideration. These provisions imply that the written notification must be provided to the taxpayer for the current tax years under examination. However, the examples of written notification include documents that could relate to a current examination or a prior examination (i.e., an examination of prior years that has closed). Furthermore, as currently written, these provisions do not require an examining agent to indicate to which tax years the notification applies. Therefore, some examining agents might improperly infer that an issue is under consideration in a current examination based on written notification provided to the taxpayer in a prior examination.

The AICPA recommends that Section 3.08(1) of Rev. Proc. 97-27 and Section 3.09(1) of Rev. Proc. 2002-9 be revised to make it clear that the written notification must be provided to the taxpayer for the tax year(s) currently under examination. In addition, these provisions should be revised to clearly indicate that the taxpayer's method of accounting for an item is not an issue under consideration for the tax year(s) under examination if written notification was provided to the taxpayer for a previous tax year that is no longer under examination. In other words, written notification citing the treatment of an item as an issue under consideration for a prior examination that has ended does not result in the item being an issue under consideration in a current examination. Separate written notification citing the item as an issue under consideration must be provided to the taxpayer during the current examination in order for the item to be an issue under consideration for the current examination.

The AICPA believes that this clarification to Rev. Proc. 97-27 and Rev. Proc. 2002-9 will further encourage taxpayers to voluntarily comply with proper tax accounting methods, and will provide taxpayers and examining agents with clearer and more consistent guidance.

E. Modification of the spread period of the section 481(a) adjustment.

Rev. Proc. 97-27 and Rev. Proc. 2002-9 both explicitly state that one of their purposes is to encourage prompt voluntary compliance with proper tax accounting principles by providing more favorable terms and conditions than if the taxpayer is required to change its method of accounting as part of an IRS examination. Generally, when a taxpayer changes an accounting method, it must compute a section 481(a) adjustment to prevent an omission or duplication of income or expense and to mitigate "distortions of income that result from accounting method changes." The section 481(a) adjustment is computed as of the beginning of the year of change and equals the difference between the amount under the taxpayer's present method and the amount under the proposed method.

Pursuant to Rev. Proc. 2002-19, a taxpayer filing a method change under either Rev. Proc. 2002-9 or Rev. Proc. 97-27 may deduct the entire amount of a net negative section 481(a) adjustment (i.e., an adjustment that reduces taxable income) in one tax year, whereas previously a taxpayer generally had to spread a net negative section 481(a) adjustment over four tax years. Positive section 481(a) adjustments (i.e., adjustments that increase taxable income), on the other hand, generally must be spread ratably over four tax years. Allowing a taxpayer that is changing to a less favorable method to spread the increase in taxable income generally over four tax years is an example of one of the provisions of Rev. Proc. 97-27 and Rev. Proc. 2002-9 intended to encourage voluntary compliance by taxpayers.

1. Currently, taxpayers may take the entire positive adjustment into account in one year only if the section 481(a) adjustment is less than $25,000. However, much larger section 481(a) adjustments still are not material to many taxpayers. Thus, the AICPA recommends that the IRS modify Section 7.03(1) of Rev. Proc. 97-27 and Section 5.04(3) of Rev. Proc. 2002-9 to allow a taxpayer to elect to use a one-year adjustment period in lieu of the section 481(a) adjustment period otherwise provided by such revenue procedure if the positive section 481(a) adjustment is $1 million or less. The AICPA believes that this change will alleviate the administrative burden of keeping track of immaterial section 481(a) adjustments.

Alternatively, the AICPA would prefer the IRS to give taxpayers the option of taking the entire amount of a positive section 481(a) adjustment into account in one tax year regardless of the size of the adjustment. As previously stated, a significant purpose of spreading a positive section 481(a) over four tax years is to create an incentive for voluntary compliance. However, some taxpayers actually would prefer to take the entire amount of a positive section 481(a) into account in the year of change. Thus, in the interest of providing an incentive for these taxpayers to comply with proper tax accounting methods, the AICPA believes taxpayers should have the option to take the entire section 481(a) adjustment into account in one year, which arguably is the treatment contemplated by the statute.

2. The AICPA also recommends that the IRS provide an exception to the short tax year rule that requires a pickup of one quarter of the positive section 481 adjustment in each short tax year in the case of section 381 transactions and section 351 transactions within the same consolidated group. Sections 5.04(3)(c)(iv) and 5.04(3)(c)(v) of Rev. Proc. 2002-9, and Sections 7.03(3)(d) and 7.03(3)(e) of Rev. Proc. 97-27 provide a similar exception related to the acceleration rule when a taxpayer transfers substantially all the assets of the trade or business that gave rise to the section 481(a) adjustment to another taxpayer in a transfer to which section 381(a) (or section 351 within a consolidated group) applies and the accounting method change which gave rise to the section 481(a) adjustment is a tax attribute that is carried over and used by the acquiring corporation immediately after the transfer; however, there is not an exception for the short year rule. Absent an exception, one quarter of the section 481(a) adjustment would be picked up in each short tax year. The AICPA believes that preventing the acceleration of a section 481(a) adjustment spread period as a result of a short tax year within a consolidated group will further the purpose of sections 351 and 381 to permit changes in form without tax effect and will be more consistent with the consolidated return principles embodied in the section 1502 regulations.

F. Revision and clarification of window periods for taxpayers under examination.

Both Rev. Proc. 97-27 and Rev. Proc. 2002-9 provide window periods in which taxpayers that are under examination may file for a change in method of accounting. The 90-day window period allows a taxpayer under examination to file a Form 3115 within 90 days from the beginning of its tax year, if the taxpayer has been under examination for at least 12 consecutive months as of the first day of the tax year. Therefore, a taxpayer that has been under examination for at least 12 consecutive months as of the first day of a tax year may file a Form 3115 within 90 days from the beginning of the tax year to request a change in accounting method. The 90-day window is not available if the method of accounting the taxpayer is requesting to change is an issue the examining agent has placed in suspense or is an issue under consideration at the time the Form 3115 is filed. The requesting taxpayer must provide a copy of the Form 3115 to the examining agent at the time it files the Form 3115 with the IRS National Office.

The 120-day window period allows a taxpayer under examination to file a Form 3115 during the first 120-day period following the date an examination ends, regardless of whether a subsequent examination has commenced. This 120-day window is not available if the method of accounting the taxpayer is requesting to change is an issue the examining agent has placed in suspense or is an issue under consideration at the time the Form 3115 is filed. The requesting taxpayer must provide a copy of the Form 3115 to the examining agent for any examination that is in process at the time the Form 3115 is filed with the IRS National Office.

The window periods were designed by the IRS to allow some opportunity to taxpayers under IRS examination that discovered they were using an erroneous method of accounting to voluntarily change to proper accounting methods. However, the AICPA is concerned that the current window periods actually frustrate voluntary compliance in many instances. Accordingly, the AICPA recommends that taxpayers be given a greater opportunity to correct erroneous methods of accounting even when the taxpayer is currently under examination. Notwithstanding the IRS's apparent belief that taxpayers are more likely to wait until contacted for examination to file a method change to correct erroneous methods of accounting, taxpayers under examination that identify erroneous methods currently are being put into an untenable position of choosing to either violate the consent requirements of section 446(e) by changing without the Commissioner's consent or file a tax return using an erroneous method of accounting. This inability to file method changes also creates FIN 48 compliance issues for taxpayers and section 6694 concerns for practitioners.

Accordingly, the AICPA recommends the following changes be made to the window periods provided in Rev. Procs. 2002-9 and 97-27.

1. The AICPA recommends that the IRS consider replacing the window periods with an "issue under consideration" standard under which taxpayers will not be precluded from filing a method change unless the issue is under consideration by exam, appeals or a federal court.

   Under the current method change procedures, a taxpayer that is under examination generally is precluded from filing a voluntary method change request unless it is in a window period (or requests the consent of the director). As described in more detail below, some taxpayers will not be in a window period until up to 23 months after they are contacted for exam. Other taxpayers that identify an erroneous method during the preparation of the tax return may be unable to change that method until months later when their next window period opens. As a result, taxpayers under examination that identify erroneous methods currently are being put into an untenable position of choosing to either violate the consent requirements of section 446(e) by changing without the Commissioner's consent or file a tax return using an erroneous method of accounting. The AICPA believes that instead of modifying or adding additional window periods to address this concern, the IRS might obtain more timely compliance with accounting method rules by simply providing an "issue under consideration" standard under which taxpayers under examination may change methods at any time during the year as long as the issue is not an issue under consideration.

   Note that an issue under consideration standard theoretically should not be any more difficult to apply or administer than the existing window periods because a request to a change a method of accounting currently can be filed in a window period only if the method is not an issue under consideration at exam or appeals or before a federal court. As a result, taxpayers that are under examination still are required to determine whether the applicable method is an issue under consideration. In fact, an issue under consideration standard would be much easier to apply than considering multiple window periods combined with an issue under consideration standard.

Accordingly, the AICPA believes providing an issue under consideration standard as the scope restriction for taxpayers under examination in Rev. Proc. 97-27 and Rev. Proc. 2002-9 will further encourage taxpayers to voluntarily comply with proper tax accounting methods in a more timely manner, provide taxpayers with more clear and consistent guidance, and assist taxpayers in complying with FIN 48 and practitioners with section 6694.

2. As an alternative, if the IRS and Treasury do not agree to an issue under consideration standard, the AICPA recommends the following additional window periods.

   a. The AICPA recommends that the IRS change the requirement of the current 90-day window period in Section 6.01(2) of Rev. Proc. 97-27 and Section 6.03(2) of Rev. Proc. 2002-9 that the taxpayer must be under examination for at least 12 months in order to be eligible for such window period to six months. Accordingly, a taxpayer under examination at least six months as of the first day of its tax year would be permitted to change a method that is not an issue under consideration during the first 90 days of its tax year.

      The 12-month restriction period adversely impacts smaller taxpayers that are not under continuous examination. Furthermore, the 12-month restriction period can actually result in up to a 23-month restriction period when a taxpayer is contacted for examination in the first month of its tax year. Under such a scenario, the taxpayer would not be eligible for the 90-day window period in the next succeeding tax year because the taxpayer would not have been under continuous examination for 12 complete consecutive months. Accordingly, such a taxpayer only would become eligible for the current 90-day window period in the second succeeding tax year, or after a period of 23 months from when the taxpayer was initially contacted for examination. This seemingly unintended result appears to be overly harsh and acts as a disincentive for prompt voluntary compliance by smaller taxpayers.

      This revision also is supported by the fact that the examination division has changed how it approaches an examination of a taxpayer since the 90-day window period was developed. Now the examination division often arrives on the first day of the scheduled examination with a detailed listing of items to be looked at, rather than developing the issues over the 12-month period such that those items are issues under consideration and are not eligible to be changed, even in a window period. Under this proposal, the proposed six month period still would protect the IRS examination division's interest in identifying any issues that examination wishes to pursue because the taxpayer still would be precluded from changing its method of accounting for an issue that is under consideration by examination.

      Therefore, the AICPA recommends that the IRS change the number of months that a taxpayer is required to be under IRS examination for the 90-day window periods of

Section 6.01(2) of Rev. Proc. 97-27 and Section 6.03(2) of Rev. Proc. 2002-9 to six months.

b. Similar to the suggestion in our prior letter dated January 31, 2008, the AICPA recommends that the IRS add an additional 90-day window period consisting of 30 days before filing a tax return and 60 days after filing a tax return when the issue is not under consideration.

Taxpayers typically identify erroneous methods during the preparation of their tax returns, but, due to the under exam rules, are precluded from changing the erroneous method until months later during the next 90- or 120-day window period. As a result, taxpayers under examination that identify erroneous methods currently are being put into an untenable position of choosing to either violate the consent requirements of section 446(e) by changing without the Commissioner's consent or filing a tax return using an erroneous method of accounting. The AICPA believes that providing an additional window period for the 30-day period before a tax return is filed and the 60-day period after a tax return is filed will further encourage taxpayers to voluntarily comply with proper tax accounting methods, as well as assist taxpayers in complying with FIN 48 and practitioners in complying with section 6694.

3. Clarify how the window periods apply to members that join or leave a consolidated group.

Both Rev. Proc. 97-27 and Rev. Proc. 2002-9 provide that a member of a consolidated group is not considered to be under examination, and therefore may apply for a change in an accounting method, as long as it is (or was) not a member of the consolidated group for the years the group is under examination. The AICPA recommends that the IRS clarify the applicability of the window periods for taxpayers in situations in which the taxpayer itself is not under examination, but is deemed to be under examination due to the examination status of a predecessor consolidated group of which the taxpayer is no longer a member. The AICPA believes that such a taxpayer should be eligible to use any window periods available to members of the predecessor consolidated group.

The AICPA understands that there is some uncertainty as to whether a subsidiary of a consolidated group is permitted to file a change under the window periods provided by Section 6 of Rev. Proc. 97-27 in the following circumstances.

- Assume that Corporation X and Subsidiaries' (the X consolidated group) with a tax year ended December 31, 2001 is under exam for more than 12 months as of January 1, 2008. Subsidiary Y was not a member of the X consolidated group during the 2001 tax year. Further, assume that Subsidiary Y joined the X consolidated group in 2002 and that an examination of the X consolidated group return for the 2002 tax year began on December 1, 2007. Subsidiary Y is not under examination with respect to any tax years prior to it joining the X consolidated group.

Uncertainty exists as to whether the 90-day window period provided by Section 6.01(2) of Rev. Proc. 97-27 (or Section 6.03(2) of Rev. Proc. 2002-9) would be available with respect to Subsidiary Y beginning January 1, 2008 since Subsidiary Y separate from the consolidated group has not been under examination for 12 consecutive months as of the first day of the 2008 calendar tax year.

For purposes of determining whether a taxpayer is "under examination," Section 3.01(2) of Rev. Proc. 97-27 defines the term "taxpayer" to include a consolidated group. (An identical definition is provided by Section 3.03(2) of Rev. Proc. 2002-9.) Section 4.02(2) of Rev. Proc. 97-27 then provides that, if a taxpayer (again as defined in Section 3.01 of Rev. Proc. 97-27, including the modification for consolidated groups made by Section 3.01(2) of Rev. Proc. 97-27) is under examination, it is generally not permitted to file a method change unless one of the exceptions provided by Section 6 of Rev. Proc. 97-27 applies. This same rule applies in the context of an automatic change filed under Rev. Proc. 2002-9. Compare Section 4.02(2) of Rev. Proc. 97-27 and Section 4.02(1) of Rev. Proc. 2002-9. In the above described example, Subsidiary Y is under examination for the 2002 tax year by virtue of being a member of the X consolidated group during the 2002 tax year. See Sections 3.01(2) of Rev. Proc. 97-27 and 3.01(7) of Rev. Proc. 2002-9. Accordingly, Subsidiary Y is not permitted to file a method change unless one of the exceptions provided by Section 6 applies.

The AICPA believes that as of January 1, 2008, Subsidiary Y has been under examination for at least 12 consecutive months by virtue of being a member of the X consolidated group. This result is discerned from the specific cross reference provided in Section 3.01(2) of Rev. Proc. 97-27 to Section 6.01 of Rev. Proc. 97-27 to determine the definition of "taxpayer" for purposes of the exceptions provided in Section 6. In other words, Rev. Proc. 97-27 specifically indicates that for purposes of the window periods provided in Section 6, the term "taxpayer" includes a consolidated group, which includes all the members of the consolidated group. However, the AICPA also understands that the application of the exceptions provided by Section 6 of Rev. Proc. 97-27 in this circumstance is somewhat unclear given the lack of a similar cross reference to the definition of "taxpayer" in the context of the exceptions for a taxpayer under examination provided by Section 6.03 of Rev. Proc. 2002-9. Compare Section 3.01(2) of Rev. Proc. 97-27 and Section 3.03(2) of Rev. Proc. 2002-9. Note that a similar uncertainty would exist with respect to the application of the 120 day window period if the X consolidated group ends an examination for a tax year(s) in which Subsidiary Y was not a member.

Accordingly, the AICPA requests that the Service and the Treasury Department confirm the AICPA's understanding of the application of the 90 and 120 day window period exceptions provided by Section 6 of Rev. Proc. 97-27 as applied to the above example and clarify that the 90 and 120 day window period exceptions provided by Section 6 of Rev. Proc. 2002-9 apply to automatic method changes filed by a member joining the consolidated group when such exceptions apply to consolidated group.

4. Clarify the application of the window periods to foreign corporations.

According to Treas. Reg. section 1.964-1T(c), the controlling domestic shareholder(s) of a foreign corporation generally must follow all the applicable procedural rules under section

446, including the applicable administrative procedures, to obtain the consent of the Commissioner to change the method of accounting of the foreign corporation. To determine whether a foreign corporation is eligible to file a method change under either Rev. Proc. 2002-9 or Rev. Proc. 97-27, it is our understanding (as discussed above) that a foreign corporation is under exam if its Form 5471 is included in the tax return of a U.S. shareholder that is under exam.

As such, the AICPA believes that a foreign corporation should be eligible to use the window periods available to its controlling domestic shareholders. The AICPA recommends that the IRS clarify how the window period rules apply to foreign corporations. Specifically, if the foreign corporation and its controlling domestic shareholder(s) have different tax years, is the 90-day window based on the tax year of the foreign corporation or the controlling domestic shareholder(s)' year? Note that, if the foreign corporation has more than one controlling domestic shareholder and each of those shareholders has a different tax year, computing the 90-day window period based on the shareholders' tax year would result in more than one 90 day window or in different 90-day window periods for each shareholder. Consequently, the AICPA recommends that the 90-day window period be based on the foreign corporation's tax year.

Similarly, clarification is needed on the application of the 120-day window period to foreign corporations because the foreign corporation could be under exam as a result of an exam of one or more of its controlling domestic shareholders. As such, the AICPA recommends that the foreign corporation be treated as having a 120-day window period if any one of its controlling domestic shareholders closes an examination (and the issue is not under consideration in other examinations).

G. Eliminate the requirement of a separate disclosure statement of audit or court action.

The AICPA recommends that the IRS eliminate the requirement in Sections 6.01(2) and 6.01(3) of Rev. Proc. 97-27 and Sections 6.03(2) and 6.03(3) of Rev. Proc. 2002-9 for a separate statement signed by a taxpayer under examination disclosing whether the method to be changed is an issue under consideration or has been placed in suspense, because it is a common “foot fault” for taxpayers and no longer necessary as the current version of Form 3115 adequately addresses this issue. The taxpayer should simply use the checked box on line 4b of the Form 3115 to indicate this fact.

H. Modify the director consent requirement.

1. The AICPA recommends that the IRS specifically indicate that the director consent does not imply that the director is approving the requested change in method of accounting. It is the experience of members of the AICPA that the provisions of Section 6.01(4) of Rev. Proc. 97-27 and Section 6.03(4) of Rev. Proc. 2002-9 are not sufficiently clear to many examining agents, team leaders, and other individuals engaged in IRS examinations of taxpayers. A

common misconception is that the director's consent somehow implies the director is agreeing or approving such method change.

2. In addition, the AICPA recommends that Rev. Proc. 97-27 and Rev. Proc. 2002-9 be modified to provide specific examples of when it is proper to give consent and when it is proper to withhold consent. For example, the AICPA recommends that the IRS more clearly state that the director must consent to the filing of an application for a method change that has a negative section 481(a) adjustment, unless the director can demonstrate unusual or compelling reasons that consent should not be granted (e.g., the same change in an earlier open year results in a positive section 481(a) adjustment). This revision is appropriate based on our understanding that it was intended that director consent be routinely granted when the method change involves a negative section 481(a) adjustment. We suggest the following example be inserted.

   For example, a change in method of accounting from a permissible or an impermissible method of accounting to a permissible method resulting in a negative section 481(a) adjustment (i.e., decrease in taxable income) would not ordinarily be included as an item of adjustment in the year(s) for which the taxpayer is under examination. As such, the director is required to consent to the filing of an application for change in accounting method when the change results in a negative section 481(a) adjustment unless the director can demonstrate unusual or compelling reasons that consent should not be granted.

3. The AICPA also recommends that the IRS provide a specific rule indicating that, to the extent a director withholds consent, the taxpayer's proposed method change must be implemented as part of the IRS examination. The AICPA believes that this requirement would encourage examining agents and team leaders to consent to a taxpayer's request to file a Form 3115 with the IRS national office, unless the IRS intends to include the method change as an item of adjustment in the year(s) for which the taxpayer is under examination.

   IRS examination teams sometime withhold their consent only to leave the taxpayer on the "old" method of accounting. The administration of the tax law for accounting methods is not served when taxpayers are deprived of the administrative procedures to change their methods of accounting. The AICPA believes that this revision to Rev. Proc. 97-27 and Rev. Proc. 2002-9 will further encourage compliance with proper tax accounting methods in a more timely manner, and facilitate the IRS' examination process, as well as assist taxpayers in complying with FIN 48 and practitioners in complying with section 6694.

4. Furthermore, the AICPA recommends that the IRS clarify when the director consent must be attached to the Form 3115. While Section 6.01(4) of Rev. Proc. 97-27 and Section 6.03(4) of Rev. Proc. 2002-9 provide that the director consent must be attached to the Form 3115, Section 6.03(4) of Rev. Proc. 2002-9 also provides that the taxpayer must attach a statement certifying that it has obtained written director consent to file the Form 3115 and that the taxpayer will maintain a copy of such consent available for inspection. The Form 3115 Instructions (revised May 2006) provide that the director consent must be attached to the Form 3115 filed with the IRS National Office and, for a Form 3115 filed with the filer's income tax return under the automatic change procedures, the taxpayer must submit a written

statement certifying that (a) the written consent was obtained from the director and (2) the applicant will retain a copy of the consent for inspection by the IRS.

These inconsistent instructions cause much confusion regarding when or whether the director consent must be attached to the Form 3115. Therefore, the AICPA recommends that Section 6.01(4) of Rev. Proc. 97-27, Section 6.03(4) of Rev. Proc. 2002-9, and the Form 3115 Instructions be revised to give taxpayers the option to (a) attach the director consent to the Form 3115 that is filed with the IRS National Office or (b) submit the director consent to the IRS National Office after the Form 3115 is filed with the IRS National Office. In addition, for a Form 3115 filed with the income tax return under the automatic change procedures, the taxpayer should have the option to either attach the director consent to the Form 3115 or to submit the written statement provided in the current version of the Form 3115 Instructions.

I. Clarify the incomplete Form 3115 rule.

Section 8.09 of Rev. Proc. 97-27 and Section 10.02 of Rev. Proc. 2002-9 both provide procedures for the IRS national office to obtain supplemental information from the taxpayer that has filed a Form 3115. Notwithstanding these procedures regarding an incomplete Form 3115, it is possible that IRS personnel could misinterpret this provision because the provisions in Section 9.03 of Rev. Proc. 2008-1 provide, in part, that a taxpayer must provide all information requested on the Form 3115 and in its instructions to be eligible for approval of the requested accounting method change.

1. The AICPA recommends that the IRS specifically state in Section 8.09 of Rev. Proc. 97-27 and Section 10.02 of Rev. Proc. 2002-9 that a Form 3115 may be submitted without a section 481(a) adjustment.

   A taxpayer is required to file the Form 3115 by a date certain, (e.g., the end of its tax year, the extended due date of its return, or the end of a window period). A taxpayer is often unable to precisely calculate the section 481(a) adjustment, or to even determine a reasonable estimate, at the time the Form 3115 is filed. As such, some taxpayers must file a Form 3115 without a section 481(a) adjustment. The IRS national office’s informal ruling position is to allow taxpayers to submit the section 481(a) adjustment at a later date. However, because the procedures in Rev. Proc. 97-27 and Rev. Proc. 2002-9 do not specifically state what type of missing information is subject to the incomplete Form 3115 rule, it is possible that a taxpayer’s Form 3115 might be considered to be invalid, rather than simply unperfected, given the language in Section 9.03 of Rev. Proc. 2008-1.

   Accordingly, the AICPA recommends that the IRS specifically state in Section 8.09 of Rev. Proc. 97-27 and Section 10.02 of Rev. Proc. 2002-9 that a Form 3115 may be submitted without a section 481(a) adjustment and that such omission does not result in the Form 3115 being deemed invalid. The AICPA believes that this revision will further encourage compliance with proper tax accounting methods and provide for more certainty to the processing of Forms 3115.

2. The AICPA also recommends that the IRS specifically state in Section 6.01(4) of Rev. Proc. 97-27 and Section 6.03(4) of Rev. Proc. 2002-9 that a Form 3115 may be submitted without the director consent statement.

   A taxpayer is often unable to obtain the director consent statement prior to the due date of the Form 3115 (e.g., the end of its tax year or the extended due date of its return, as applicable). As such, some taxpayers must file a Form 3115 without the director consent statement. The IRS national office's informal ruling position is to allow taxpayers to later submit director consent. However, because the procedures contained in Rev. Proc. 97-27 and Rev. Proc. 2002-9 do not specifically state what type of missing information is subject to the incomplete Form 3115 rule, it is possible that such a taxpayer's Form 3115 might be considered to be invalid, rather than simply unperfected, given the language in Section 9.03 of Rev. Proc. 2008-1.

   Accordingly, the AICPA recommends that the IRS specifically state in Section 6.01(4) of Rev. Proc. 97-27 and Section 6.03(4) of Rev. Proc. 2002-9 that a Form 3115 may be submitted without the director consent statement and that such omission does not result in the Form 3115 being deemed invalid. The AICPA believes that this revision will further encourage compliance with proper tax accounting methods and provide for more certainty to the processing of Forms 3115.

J. Modify Section 8.13 of Rev. Proc. 97-27 and Section 6.02(8) of Rev. Proc. 2002-9 to conform to Rev. Proc. 2008-1.

The AICPA applauds the expansion of taxpayers eligible to file a single Form 3115 as provided in Rev. Procs. 2007-1 and 2008-1; however the AICPA recommends that these changes be reflected in any update to Rev. Procs. 97-27 and 2002-9. Accordingly, the AICPA recommends that the IRS modify Section 8.13 of Rev. Proc. 97-27 and Section 6.02(8) of Rev. Proc. 2002-9 to reflect that, not only can a parent corporation file a single application to change an identical method of accounting on behalf of more than one member of a consolidated group, but (1) multiple trades or businesses of a single entity that are changing an identical method of accounting, including QSubs and single member LLCs; and (2) two or more CFCs that do not engage in a trade or business within the U.S. when all controlling U.S. shareholders of the CFCs are members of the consolidated group or for which the taxpayer is the sole controlling U.S. shareholder of the CFCs, also may file a single application.

The AICPA believes that this revision will further encourage compliance with proper tax accounting methods and provide for more certainty and transparency to the processing of Forms 3115.

MODIFICATIONS TO THE PROCEDURAL RULES FOR AUTOMATIC METHOD CHANGES

A. Modify the prior year change for the same method of accounting scope limitation.

1. The AICPA recommends that the IRS clarify that a "prior change" does not include a situation in which an examining agent or appeals officer made a change to a taxpayer's method of accounting for the same item. Section 4.02(6) of Rev. Proc. 2002-9 provides that a taxpayer that made a change in the same method of accounting (with or without obtaining the Commissioner's consent), or applied to change the same method of accounting without effecting the change (whether the application to change was withdrawn, not perfected, not granted, or denied) within the last five tax years (including the year of change), is precluded from filing such request under Rev. Proc. 2002-9.

   The AICPA does not believe that the automatic accounting method change procedures should exclude a taxpayer that has had an involuntary accounting method change imposed on it as a result of the IRS examination process. The long-standing limitation on taxpayers that have made the same accounting method change within the last five years arose out of a desire by the IRS national office to limit the ability of taxpayers who voluntarily change their method of accounting for the same item.

   The AICPA acknowledges that section 446(b) provides that, if the Commissioner determines that a taxpayer's method of accounting does not clearly reflect income, the IRS may select a method which, in its opinion, does clearly reflect income. In the IRS examination process, however, examining agents, as well as appeals officers, often do not always place a taxpayer on the most appropriate method available, and instead place the taxpayer on a method of their own choosing. For example, the IRS often will change a taxpayer from an impermissible method of accounting for advance payments to the cash method, rather than allowing the taxpayer to use Treas. Reg. section 1.451-5 or Rev. Proc. 2004-34. Under these circumstances, there is no reason why the IRS national office should have to use its limited resources to process an accounting method change that otherwise would qualify for automatic consent under the procedures of Rev. Proc. 2002-9.

   It also must be noted that the interpretation of this restriction has not been consistently applied by the IRS national office. Some individuals in the IRS national office believe that an involuntary accounting method change imposed on a taxpayer by an IRS examiner counts as a prior change in method and would preclude a taxpayer from using the automatic method change procedure, whereas other individuals in the IRS national office believe that such a taxpayer is not precluded from filing automatically.

   Therefore, the AICPA recommends that the IRS clarify that a "prior change" does not include a situation in which an examining agent or appeals officer made a change to a taxpayer's method of accounting for the same item that the taxpayer now wants to change automatically to another method in the current year. The AICPA believes that this revision will further encourage compliance with proper tax accounting methods and conserve IRS resources with respect to processing Forms 3115.

2. The AICPA recommends that the IRS exempt an automatic last-in, first-out (LIFO) termination from the prior change scope limitation (i.e., taxpayer elected the LIFO inventory method within the last five years). Many taxpayers must change to the first-in, first-out (FIFO) inventory method as a result of failure to continue to comply with the financial statement conformity requirement due to an acquisition or to a change to international financial reporting standards (IFRS). The AICPA does not believe the IRS national office should place impediments on a taxpayer's ability to discontinue the use of the LIFO inventory method, particularly in these circumstances.

   Accordingly, the AICPA believes that the automatic accounting method change procedures should not exclude a taxpayer changing from the LIFO inventory method when it changed to LIFO within the past five years. The AICPA believes that this revision will further encourage compliance with proper tax accounting methods and conserve IRS national office resources.

B. Modify and clarify Section 9.02 of Rev. Proc. 2002-9

Section 9.02 of Rev. Proc. 2002-9 provides guidance for "Director" review and requires the director to apply a change in method of accounting "made in compliance" with Rev. Proc. 2002-9. Currently, if the director determines an accounting method change was not made in compliance with the provisions of Rev. Proc. 2002-9, the director has three options:

1. Deny the change and require taxpayer to use the old method;

2. Deny the change and place taxpayer on another method (presumably one chosen by the director); or

3. Make adjustments that are necessary to bring the change into compliance with Rev. Proc. 2002-9.

Some examiners have taken the position that section 9.02 of Rev. Proc. 2002-9 allows them to reject the Form 3115 in its entirety, even if the taxpayer only made a "foot fault" in its Form 3115 or even if only one aspect of the method is non-compliant. Although most of these disputes are ultimately resolved in the taxpayer's favor, significant taxpayer and government resources are unnecessarily expended. Section 9.02 of Rev. Proc. 97-27 should be clarified to explicitly limit the scope of the examiner's discretion.

The AICPA recommends that when a change in method of accounting is not made in compliance with the provisions of Rev. Proc. 2002-9, the director will ordinarily make adjustments that are necessary to bring the change into compliance with the provisions of Rev. Proc. 2002-9. Thus, for example, in the case of a taxpayer that makes a change in method of accounting to a burden rate method for purposes of section 263A, using a cost driver for a particular cost that the director determines is inappropriate, the director will require a change to an appropriate cost driver. However, the director will not deny the change in its entirety and place the taxpayer on its prior, or another, method. If, however, the taxpayer makes a change that is not within the scope of the automatic change provisions, the director may deny the method change and place the taxpayer on its prior, or another, method.

The AICPA believes that this revision to Rev. Proc. 2002-9 will further conserve taxpayer and government resources, and provide for more certainty to the processing of Forms 3115.

C. Clarify the rules governing supplemental information requests for automatic accounting method changes.

The AICPA recommends that the IRS limit additional information requests related to automatic method changes to whether the taxpayer is within the scope of the automatic procedure, or to obtain required information that was not submitted with the Form 3115 (e.g., section 481(a) adjustment, director consent). The IRS has designated over 100 mostly routine and non-controversial accounting method changes as automatic. The purpose of Rev. Proc. 2002-9 is to reduce the number of requests for supplemental information in the advance consent process and the time spent by the IRS national office in processing Forms 3115. Although Section 10.02 of Rev. Proc. 2002-9 provides procedures for the IRS national office to obtain supplemental information from the taxpayer that has filed a Form 3115 for an automatic method change, in some instances members of the AICPA have found that some IRS national office personnel treat some selected automatic Forms 3115 as if they were filed as non-automatic accounting method changes. In this regard, some IRS national office personnel request additional information regarding substantive issues of the Form 3115. While the AICPA agrees that the IRS national office has both a right and a duty to ensure the integrity of the automatic method change process, the AICPA believes that such inquiries should focus primarily on establishing whether the taxpayer’s Form 3115 is within the scope of Rev. Proc. 2002-9.

Therefore, the AICPA recommends that the IRS additional information requests be limited to whether the taxpayer is within the scope of the automatic procedure, or to obtain required information that was not submitted with the Form 3115. The AICPA believes that this revision will further encourage compliance with proper tax accounting methods and facilitate efficient processing of accounting method changes.