Part III

Administrative, Procedural and Miscellaneous

26 CFR 601.204: Changes in accounting periods and in methods of accounting.
(Also Part I, §§ 446, 448, 481)

Rev. Proc. 2011-46

SECTION 1. PURPOSE

This revenue procedure provides a book safe harbor method of accounting for taxpayers using the nonaccrual-experience (NAE) method of accounting under § 448(d)(5) of the Internal Revenue Code and § 1.448-2 of the Income Tax Regulations. This revenue procedure also provides the procedures by which a taxpayer may obtain automatic consent (1) to change to the NAE book safe harbor method, and (2) to make certain changes within the NAE book safe harbor method.

SECTION 2. BACKGROUND

.01 Section 448(d)(5) provides that certain taxpayers may use the NAE method to account for amounts to be received for the performance of services. In general, taxpayers eligible to use a NAE method are not required to accrue any portion of amounts that, based on the taxpayer's experience, will not be collected.

.02 The NAE method is available only to a taxpayer using an accrual method of accounting that either provides services in a field described in § 448(d)(2)(A) (health, law, engineering, architecture, accounting, actuarial science, performing arts, or consulting), or that meets the $5 million annual gross receipts test of § 448(c). The NAE method may not be used for amounts for which the taxpayer charges interest or penalties for failure to timely pay. See § 448(d)(5)(B) and § 1.448-2(c)(1)(ii).

.03 Section 448(d)(5)(C) provides that the Secretary shall provide guidance that permits taxpayers to use computations and formulas that, based on experience, accurately reflect the amount of income that a taxpayer will not collect (the uncollectible amount).

.04 Section 1.448-2(f) describes safe harbor NAE methods that a taxpayer may use to determine the uncollectible amount. Section 1.448-2(b) provides that, except as provided in other published guidance, a taxpayer that wishes to change to a NAE method other than one of the safe harbor methods must request advance consent from the Commissioner.

.05 Rev. Proc. 2011-14, 2011-4 I.R.B. 330, provides procedures for a taxpayer to obtain automatic consent of the Commissioner to change to a method of accounting described in the Appendix to Rev. Proc. 2011-14.

.06 Rev. Proc. 2006-56, 2006-2 C.B. 1169, provides procedures for requesting the consent of the Commissioner to make certain changes to, from, or within a NAE method of accounting and to adopt certain NAE methods.

SECTION 3. SCOPE

This revenue procedure applies to a taxpayer that is eligible to use the NAE method of accounting under § 448(d)(5) and § 1.448-2, and has an applicable financial statement, as defined in section 4.02 of this revenue procedure.

SECTION 4. APPLICATION

.01 NAE book safe harbor.

(1) In general. A taxpayer within the scope of this revenue procedure may compute its uncollectible amount under the NAE book safe harbor method by multiplying the portion of the year-end allowance for doubtful accounts on the taxpayer's applicable financial statement that is attributable to current year NAE-eligible accounts receivable by 95 percent. A taxpayer using the NAE book safe harbor is generally subject to the rules in § 1.448-2; however, the NAE book safe harbor is not subject to the self-testing requirements of § 1.448-2(e).

(2) Allowance for doubtful accounts. For purposes of this revenue procedure, an allowance for doubtful accounts on a taxpayer's applicable financial statement must represent the amount of outstanding accounts receivable the taxpayer anticipates it will not collect. Therefore, an allowance that is computed to maximize the deferral of taxable income under this revenue procedure and does not represent the amount of outstanding accounts receivable the taxpayer anticipates it will not collect in the future does not qualify under this revenue procedure.

(3) Current year NAE-eligible accounts receivable. Current year NAE-eligible accounts receivable are accounts receivable described in § 1.448-2(c)(1)(i) that a taxpayer earns during the current taxable year. They do not include accounts receivable for which a taxpayer is prohibited from using the nonaccrual experience method, such as amounts not earned through the performance of services and amounts for which the taxpayer charges interest or penalties for failure to timely pay. See § 1.448-2(c)(1)(ii).

(4) Computation of NAE-eligible amount. A taxpayer may use any reasonable method to determine the amount of the taxpayer's applicable financial statement allowance for doubtful accounts that is attributable to current year NAE-eligible accounts receivable. In general, a method will not be considered reasonable if the method fails to consider relevant information that is readily available to the taxpayer that would produce a result that is materially different than the method employed by the taxpayer.

(5) Periodic system compatibility. The NAE book safe harbor is a qualifying periodic system of accounting for billings under Notice 88-51, 1988-1 C.B. 535.

.02 Applicable financial statement. A taxpayer's applicable financial statement is the taxpayer's financial statement listed in paragraphs (1) through (3) of this section 4.02 that has the highest priority (including priority within paragraph (2)). A taxpayer that does not have a financial statement described in this section 4.02 does not have an applicable financial statement for purposes of this revenue procedure. A taxpayer's financial statement that is properly incorporated into a parent's consolidated applicable financial statement that is described in this section 4.02 will qualify as an applicable financial statement. The financial statements are, in descending priority --

(1) A financial statement required to be filed with the Securities and Exchange Commission (SEC) (the 10-K or the Annual Statement to Shareholders);

(2) A certified audited financial statement that is accompanied by the report of an independent CPA (or in the case of a foreign corporation, by the report of a similarly qualified independent professional), that is used for --

(a) Credit purposes,

(b) Reporting to shareholders, or

(c) Any other substantial non-tax purpose; or

(3) A financial statement (other than a tax return) required to be provided to the federal or a state government or any federal or state agency (other than the SEC or the Internal Revenue Service).

.03 Examples.

Example 1. Application of NAE book safe harbor. (i) On December 31, 2011, the balance sheet in calendar-year Taxpayer's applicable financial statement includes an allowance for doubtful accounts of $1,300,000. Of this balance, $300,000 represents the amount attributable to current year accounts receivable that Taxpayer anticipates it will not collect in the future.

(ii) Taking into account relevant information that is readily available, Taxpayer makes a reasonable determination that $200,000 of the $300,000 current year addition to the financial statement allowance for doubtful accounts is attributable to its current year NAE-eligible accounts receivable. Taxpayer computes the amount of income that it may exclude under the NAE book safe harbor method by multiplying the $200,000 increment to the financial statement year-end allowance for doubtful accounts attributable to current year NAE-eligible accounts receivable by 95%. Therefore, the amount of income that Taxpayer is not required to accrue for federal income tax purposes under section 448(d)(5) for the taxable year ending December 31, 2011, is $190,000 ($200,000 x 95%).

Example 2. Recoveries. (i) On December 31, 2011, the balance sheet in Taxpayer's applicable financial statement includes an allowance for doubtful accounts of $1,300,000, representing outstanding accounts receivable that Taxpayer anticipates it will not collect in the future. During calendar year 2012, Taxpayer collects $100,000 of accounts receivable that had been included in its allowance for doubtful accounts.

(ii) Taking into account relevant information that is readily available, Taxpayer determines that $60,000 of the $100,000 financial statement recovery from the allowance for doubtful accounts is attributable to recoveries of NAE-eligible accounts receivable, all or a portion of which Taxpayer had properly excluded from income in a prior year under the NAE rules. As required by § 1.448-2(d)(5), Taxpayer must include the recovered amount in income in the taxable year ending December 31, 2012. The amount of additional income that Taxpayer must include under § 1.448-2(d)(5) is equal to the amount of the recovery that Taxpayer previously excluded from income under an NAE method. Thus, if in a prior year Taxpayer excluded 95% of the recovered $60,000 under the NAE book safe harbor method, Taxpayer is required to include $57,000 ($60,000 x 95%) in income in the taxable year ending December 31, 2012.

SECTION 5. CHANGE IN METHOD OF ACCOUNTING

.01 Change to the NAE book safe harbor.

(1) In general. A change in a taxpayer's method of accounting to the NAE book safe harbor method is a change in method of accounting to which the provisions of §§ 446 and 481 and the regulations thereunder apply. A taxpayer within the scope of this revenue procedure is granted the consent of the Commissioner to change to the NAE book safe harbor method permitted under section 4 of this revenue procedure if the taxpayer complies with the applicable provisions of Rev. Proc. 2006-56 and Rev. Proc. 2011-14 (or any successor).

(2) Scope limitations. The scope limitations in section 4.02 of Rev. Proc. 2011-14 (or any successor) do not apply for a taxpayer's first taxable year ending on or after September 28, 2011. However, if, at the time a taxpayer files a Form 3115 for that year with the national office, and the taxpayer's NAE method is an issue under consideration for a taxable year under examination, before an appeals office, or before a federal court, then the audit protection of section 7 of Rev. Proc. 2011-14 (or any successor) does not apply. A taxpayer's NAE method of accounting is an issue under consideration for the taxable years under examination if the taxpayer receives written notification (for example, by examination plan, information document request, or notification of proposed adjustment, or income tax examination changes) from the examining agent(s) specifically citing the treatment of the NAE method of accounting as an issue under consideration.

.02 Change in applicable financial statements and allowance for doubtful accounts.

(1) In general. A change to a taxpayer's method for determining its allowance for doubtful accounts for its applicable financial statements is a change in method of accounting to which the provisions of § 446 and the regulations thereunder apply. A taxpayer within the scope of this revenue procedure is granted the consent of the Commissioner to change this method if the taxpayer complies with the applicable provisions of Rev. Proc. 2011-14 (or any successor) and this paragraph 5.02. An adjustment to a taxpayer's estimates in determining its allowance for doubtful accounts that does not change the base or formula is not a change in the method of determining the allowance for doubtful accounts under this paragraph 5.02. For example, if a taxpayer estimates that 4% of its receivables are uncollectible in a taxable year, and

using the same methodology estimates that 6% of its receivables are uncollectible in the subsequent taxable year, the adjustment to its estimate is not a change in the method of determining the allowance for doubtful accounts.

(2) Restatement of applicable financial statements. A taxpayer's restatement of its applicable financial statements does not invalidate the taxpayer's method of accounting or change its uncollectible amount determined under the NAE book safe harbor in earlier taxable years.

(3) Manner of making change.

(a) A taxpayer makes a change in method of accounting under this paragraph 5.02 by attaching a statement to its original return for the taxable year of change (or to an amended return if under the limited relief for a late application provided in section 6.02(3)(d) of Rev. Proc. 2011-14, or any successor). The taxpayer is not required to file a copy of the statement with the national office under section 6.02(3)(a) of Rev. Proc. 2011-14 (or any successor). The statement must include the following information:

(i) The taxpayer's name and taxpayer identification number for each applicant;

(ii) The beginning and ending dates of the year of change;

(iii) For each applicant, the type of applicable financial statement (as defined in section 4.02 of this revenue procedure) the taxpayer uses;

(iv) A description of the method the taxpayer uses to determine its allowance for doubtful accounts on its applicable financial statements before and after the change; and

(v) The designated automatic accounting method change number 35.

(b) A change under this paragraph 5.02 is made on a cut-off basis and applies only to accounts receivable earned on or after the first day of the taxable year of change. A taxpayer must continue to apply its former method to accounts receivable earned before the taxable year of change. Accordingly, a § 481(a) adjustment is neither permitted nor required.

(4) Scope limitations. The scope limitation in section 4.02(7) of Rev. Proc. 2011-14 (or any successor) does not apply to a change in method of accounting under this section 5.02. A taxpayer that is otherwise ineligible to file an automatic method change because it is under examination (as defined in section 3.08 of Rev. Proc. 2011-14 (or any successor)) for any income tax issue may change its method of accounting under this paragraph 5.02, however, the audit protection provisions of section 7 of Rev. Proc. 2011-14 (or any successor) do not apply.

.03 Change in method of determining the NAE-eligible amount.

(1) In general. A change in a taxpayer's method for determining the portion of its applicable financial statement allowance for doubtful accounts that is attributable to current year NAE-eligible accounts receivable (as described in section 4.01(4) of this revenue procedure) is a change in method of accounting to which the provisions of § 446 and the regulations thereunder apply. A taxpayer within the scope of this revenue procedure is granted the consent of the Commissioner to change this method if the taxpayer complies with the applicable provisions of Rev. Proc. 2011-14 (or any successor) and this paragraph 5.03.

(2) Manner of making change.

(a) A taxpayer makes a change in method of accounting under this paragraph 5.03 by attaching a statement to its original return for the taxable year of change (or to an amended return if under the limited relief for a late application provided in section 6.02(3)(d) of Rev. Proc. 2011-14, or any successor). The taxpayer is not required to file a copy of the statement with the national office under section 6.02(3)(a) of Rev. Proc. 2011-14 (or any successor). The statement must include the following information:

(i) The taxpayer's name and taxpayer identification number for each applicant;

(ii) The beginning and ending dates of the year of change;

(iii) A description of the method the taxpayer uses to determine its NAE-eligible amount before and after the change; and

(iv) The designated automatic accounting method change number 35.

(b) A change under this paragraph 5.03 is made on a cut-off basis and applies only to accounts receivable earned on or after the first day of the taxable year of change. A taxpayer must continue to apply its former method to accounts receivable earned before the taxable year of change. Accordingly, a § 481(a) adjustment is neither permitted nor required.

(3) Scope limitation. The scope limitation in section 4.02(7) of Rev. Proc. 2011-14 (or any successor) does not apply to a change in method of accounting under this section 5.03.

SECTION 6. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 2006-56 is modified and amplified to include the NAE book safe harbor method in the safe harbors described in paragraphs (1), (7), and (8) of section 3.01 and in section 3.02. Therefore, a taxpayer may change to the NAE book safe harbor method using the provisions of section 14.04 of the APPENDIX of Rev. Proc. 2011-14 (or any successor) if the taxpayer is otherwise eligible to use Rev. Proc. 2011-14.

SECTION 7. EFFECTIVE DATE

This revenue procedure is effective for taxable years ending on or after September 28, 2011.

SECTION 8. DRAFTING INFORMATION

The principal author of this revenue procedure is W. Thomas McElroy, Jr., of the Office of Associate Chief Counsel (Income Tax and Accounting). For further information regarding this revenue procedure, contact Karla M. Meola at (202) 622-4930 (not a toll-free call).