

Part III

Administrative, Procedural, and Miscellaneous

26 CFR 601.204: Changes in accounting periods and methods of accounting.
(Also Part I, §§ 442; 1.442-1)

Rev. Proc. 2003-79

SECTION 1. PURPOSE

Rev. Proc. 2002-38, 2002-1 C.B. 1037, and Rev. Proc. 2002-39, 2002-1 C.B. 1046, provide procedures for a partnership or S corporation to change its annual accounting period if its current taxable year no longer qualifies as a natural business year (or, for certain S corporations, an ownership taxable year). This revenue procedure provides procedures under which a partner or S corporation shareholder (within the scope of this revenue procedure) of such a partnership or S corporation may elect to take into account ratably over four taxable years the partner's or S corporation shareholder's share of income from the partnership or S corporation that is attributable to the short taxable year ending on or after May 10, 2002, but before June 1, 2004.

SECTION 2. BACKGROUND

.01 Section 442 of the Internal Revenue Code and § 1.442-1(a) of the Income Tax Regulations generally provide that a taxpayer that wants to change its annual accounting period and use a new taxable year must obtain the approval of the Commissioner.

.02 Section 1.442-1(b)(2) provides, in relevant part, that a change in annual accounting period will be approved only where the taxpayer agrees to the Commissioner's prescribed terms, conditions, and adjustments for effecting the change.

.03 Section 1.442-1(b)(3) provides that such terms, conditions, and adjustments may include adjustments necessary to neutralize the tax effects of a substantial distortion of income that would otherwise result from the requested annual accounting period.

.04 Rev. Proc. 2002-38 provides the exclusive procedures for certain partnerships and S corporations to obtain automatic approval to adopt, change, or retain their annual accounting periods under § 442 and § 1.442-1(b). Among the provisions of Rev. Proc. 2002-38:

(1) Section 4 provides that a partnership or S corporation may secure the Commissioner's approval to adopt or change to its "required taxable year," a "natural business year," or an "ownership taxable year;"

(2) Section 5.04 defines a "permitted taxable year" to include a required taxable year, natural business year, or ownership taxable year;

(3) Section 5.05 provides that a partnership or S corporation establishes a natural business year by satisfying a "25-percent gross receipts test;"

(4) Section 5.06 provides generally that an S corporation shareholder that is a tax-exempt entity under § 501(a) and that is not subject to tax on any income attributable to the S corporation is disregarded for purposes of determining an ownership taxable year of the S corporation unless the S corporation is wholly-owned by such tax-exempt entity; and

(5) Sections 6.05 and 6.06 provide that if a taxpayer changes to or retains a natural business year or an ownership taxable year and that year no longer qualifies as a permitted taxable year, the taxpayer is using an impermissible annual accounting period and should change to a permitted taxable year under Rev. Proc. 2002-38 or Rev. Proc. 2002-39, whichever applies.

.05 Rev. Proc. 2002-39 provides the exclusive procedures for taxpayers, including partnerships and S corporations, that do not qualify under one of the automatic approval procedures, to obtain prior approval of the Commissioner to adopt, change, or retain their annual accounting periods under § 442 and § 1.442-1(b). Among the provisions of Rev. Proc. 2002-39:

(1) Section 5.01 provides that a request to adopt, change, or retain an annual accounting period ordinarily will be approved if the taxpayer establishes a business purpose;

(2) Section 5.02 provides that a taxpayer requesting to adopt, change, or retain an annual accounting period that is the taxpayer's natural business year has established a business purpose to the satisfaction of the Commissioner;

(3) Section 5.03 provides that a natural business year of a taxpayer may be determined under the "annual business cycle test," the "seasonal business test," or the "25% gross receipts test;" and

(4) Section 5.04 provides that if a partnership or S corporation changed to or retained under Rev. Proc. 2002-39 a taxable year that was its natural business year, and that taxable year no longer qualifies as a permitted taxable year, the partnership or S corporation is using an impermissible annual accounting period and should change to a permitted taxable year under Rev. Proc. 2002-38 or Rev. Proc. 2002-39, whichever applies.

.06 In the case of a partnership or S corporation that changes its taxable year to a permitted taxable year, a partner or S corporation shareholder may be required to include in gross income in a single taxable year income items and expense items from more than one taxable year of the partnership or S corporation. The Internal Revenue Service and Treasury Department have determined that it is appropriate to allow partners and S corporation shareholders within the scope of this revenue procedure to elect to spread ratably over a four-year period their share of income from the partnership's or S corporation's short taxable year.

SECTION 3. DEFINITIONS

For purposes of this revenue procedure:

.01 *Share of income.* The term "share of income" means a partner's or S corporation shareholder's share of "income items" that exceeds its share of "expense items" from the partnership or S corporation that are attributable to the short taxable year;

.02 *Income Items and Expense Items.* The terms "income items" and "expense items" have the same meaning as in § 1.702-3T(b).; and

.03 *Short Taxable Year.* The term "short taxable year" means the short taxable year of the partnership or S corporation that is required to effect the change in annual accounting period. An initial short year following an election under section 1362(a) will not be considered a "short taxable year" for purposes of this revenue procedure.

SECTION 4. SCOPE

This revenue procedure applies to a partner or S corporation shareholder, if:

.01 The partnership or S corporation has changed, or will change, its taxable year solely because either:

(1) its current taxable year no longer qualifies as a natural business year under Rev. Proc. 2002-38 or Rev. Proc. 2002-39, whichever applies; or

(2) in the case of an S corporation, its current taxable year no longer qualifies as an ownership taxable year because a tax-exempt owner is disregarded under section 5.06 of Rev. Proc. 2002-38;

.02 The partnership's or S corporation's short taxable year ends on or after May 10, 2002, but before June 1, 2004 (or, in the case of a taxpayer that uses a 52-53-week taxable year, with reference to the last day of any calendar month after April 30, 2002, and before June 1, 2004);

.03 As a consequence of the partnership or S corporation changing its taxable year to a permitted taxable year, income items and expense items from more than one taxable year of the partnership or S corporation would, but for the provisions of this revenue procedure, be includible in the income of the partner or S corporation shareholder in a single taxable year; and

.04 The partner's or S corporation shareholder's share of income items exceeds its share of expense items attributable to the short taxable year of the partnership or S corporation.

SECTION 5. FOUR-YEAR SPREAD PERIOD

.01 A partner or S corporation shareholder within the scope of this revenue procedure may elect to take into account its share of income from the short taxable year of the partnership or S corporation ratably over a four-year period.

.02 A partner or S corporation shareholder within the scope of this revenue procedure that elects a ratable four-year spread period under this revenue procedure must apply the provisions of § 1.702-3T (b), (d), (e), (f) and (g) with the following modifications for purposes of this section:

(1) the term "partner" in §1.702-3T means any partner or S corporation shareholder within the scope of this revenue procedure;

(2) the term "partnership" includes S corporations;

(3) the term "distributive share" includes a shareholder's pro rata share of S corporation items; and

(4) references to "section 806 of the 1986 Act" should be replaced with "Rev. Proc. 2002-38 or Rev. Proc. 2002-39, whichever applies."

SECTION 6. PROCEDURES FOR ELECTING FOUR-YEAR SPREAD PERIOD

A partner or S corporation shareholder within the scope of this revenue procedure that wants to elect to spread income ratably over a four-year period under this revenue procedure must make the election by:

(1) recording the appropriate ratable income amount (*i.e.*, one quarter of its share of income) on either:

(a) a timely filed original federal income tax return for the taxable year of the partner or S corporation shareholder with or within which the partnership's or S corporation's short taxable year ends; or

(b) in the case of a partner or S corporation shareholder within the scope of this revenue procedure that wants to make the four-year spread period election, but prior to November 24, 2003, has timely filed a federal income tax return for the taxable year with or within which the partnership's or S corporation's short taxable year ends, on an appropriate amended federal income tax return that is filed on or before April 12, 2004; and

(2) attaching to the original or amended federal income tax return for the taxable year with or within which the partnership's or S corporation's short taxable year ends, and to the federal income tax returns for every other taxable year of the spread period, a completed Form 8082, *Notice of Inconsistent Treatment or Administrative Adjustment Request*, containing an explanation in Part III similar to the following: "Election under Rev. Proc. 2003-79 to apply a ratable 4-year spread of the share of income attributable to a change in annual accounting period."

SECTION 7. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 2002-38 and Rev. Proc. 2002-39 are modified.

DRAFTING INFORMATION

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