

26 CFR 601.204: Changes in accounting periods and in methods of accounting.
(Also Part 1, § 481)

Rev. Proc. 2018-44

SECTION 1. PURPOSE

Section 13543 of “An Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018,” Pub. L. 115-97 (the Act) added § 481(d) to the Internal Revenue Code (Code). Section 481(d) provides rules relating to adjustments required by § 481(a)(2) that are attributable to certain revocations of S corporation elections under § 1362(a). This revenue procedure modifies Rev. Proc. 2018-31, 2018-22 I.R.B. 637, to reflect the statutory amendments made by the Act. Specifically, this revenue procedure requires an eligible terminated S corporation, as defined in § 481(d)(2), that is required to change from the overall cash receipts and disbursements method of accounting (cash method) to an overall accrual method of accounting (accrual method) as a result of a revocation of its S corporation election, and that makes this change in method of accounting for the C corporation’s first taxable year after such revocation, to take into account the resulting positive or negative adjustment required by § 481(a)(2) ratably during the six-year period beginning with the year of change. This revenue procedure also provides that an eligible terminated S corporation that is permitted to continue to use the cash method after the

revocation of its S corporation election and that changes to an overall accrual method for the C corporation's first taxable year after such revocation, may take into account the resulting positive or negative adjustment required by § 481(a)(2) ratably during the six-year period beginning with the year of change.

SECTION 2. BACKGROUND

.01 Section 13543 of the Act, added § 481(d) to the Code. Section 481(d)(1) requires an eligible terminated S corporation, as defined in § 481(d)(2), to take into account ratably during the six-year period beginning with the year of change any adjustment required by § 481(a)(2) that is attributable to the corporation's revocation of its election under § 1362(a) (S corporation election). Section § 481(d)(2) provides that an eligible terminated S corporation is any C corporation that: (1) was an S corporation on December 21, 2017; (2) revokes its S corporation election after December 21, 2017, but before December 22, 2019; and (3) has the same owners of stock in identical proportions on December 22, 2017, and the revocation date.

.02 Section 448 generally prohibits the use of the cash method by a C corporation (other than a farming business or a qualified personal service corporation) unless the C corporation meets the \$25,000,000 gross receipts test of § 448(c). Section 448 also prohibits tax shelters from using the cash method.

.03 Section 1362(d)(1)(A) provides that a section 1362(a) election may be terminated by revocation. Section 1362(d)(1)(B) provides that an election under section 1362(a) may be terminated by revocation only if shareholders holding more than one-half of the shares of stock of the corporation on the day on which the revocation is made consent

to the revocation. Section 1362(d)(1)(C) provides that except as provided in section 1362(d)(1)(D), a revocation made during the taxable year and on or before the fifteenth day of the third month thereof shall be effective on the first day of such taxable year, and a revocation made during the taxable year but after such fifteenth day shall be effective on the first day of the following taxable year. Section 1362(d)(1)(D) provides that if the revocation specifies a date for revocation that is on or after the day on which the revocation is made, the revocation shall be effective on and after the date so specified.

.04 Section 1362(e)(1) provides that generally in the case of an S termination year, the portion of such year ending before the first day for which the termination is effective shall be treated as a short taxable year for which the corporation is an S corporation, and the portion of such year beginning on such first day shall be treated as a short taxable year for which the corporation is a C corporation. Section 1362(e)(4) generally provides that an S termination year is any taxable year of a corporation (determined without regard to section 1362(e)) in which a termination of a section 1362(a) election takes effect (other than on the first day thereof).

.05 Section 481(a) requires those adjustments necessary to prevent amounts from being duplicated or omitted to be taken into account when the taxpayer's taxable income is computed under a method of accounting different from the method of accounting used to compute taxable income for the preceding taxable year.

.06 Under § 446(e) and § 1.446-1(e), except as otherwise provided, a taxpayer must secure the consent of the Commissioner of Internal Revenue before changing a method

of accounting for federal income tax purposes. Section 1.446-1(e)(3)(ii) authorizes the Commissioner to prescribe administrative procedures setting forth the terms and conditions necessary for a taxpayer to obtain consent to a change in method of accounting in accordance with § 446(e).

.07 Rev. Proc. 2015-13, 2015-5 I.R.B. 419, as clarified and modified by Rev. Proc. 2015-33, 2015-24 I.R.B. 1067, as modified by Rev. Proc. 2016-1, 2016-1 I.R.B. 1, and as modified by Rev. Proc. 2017-59, 2017-48 I.R.B. 543, provides the general procedures by which a taxpayer may obtain automatic consent of the Commissioner to a change in method of accounting described in the List of Automatic Changes. Rev. Proc. 2018-31 contains the current List of Automatic Changes.

.08 Section 15.01 of Rev. Proc. 2018-31 provides automatic changes for certain taxpayers that want to change their overall method of accounting from the cash method to an accrual method, including taxpayers required to make this change by § 448.

.09 This revenue procedure provides that an eligible terminated S corporation required to change from the cash method to an accrual method as a result of a revocation of its S corporation election, and that makes this change in method of accounting under section 15.01 of Rev. Proc. 2018-31 for the first taxable year that it is a C corporation, must take the resulting positive or negative adjustment required by § 481(a)(2) into account ratably during the six-year period beginning with the year of change. See § 481(d)(1). This revenue procedure also allows an eligible terminated S corporation that is permitted to continue to use the cash method after the revocation of its S corporation election and that changes to an accrual method under section 15.01

of Rev. Proc. 2018-31 for the first taxable year that it is a C corporation, to take the resulting positive or negative adjustment required by § 481(a)(2) into account ratably during the six-year period beginning with the year of change. See § 1.446-1(e)(3)(ii).

.10 In addition to the change to an accrual method described in section 15.01 of Rev. Proc. 2018-31, an eligible terminated S corporation may have other changes in method of accounting that result in adjustments required by § 481(a) that are attributable to such corporation's revocation of its S corporation election as described in § 481(d)(2). Any such change is not within the scope of this revenue procedure.

SECTION 3. MODIFICATION TO REV. PROC. 2018-31

.01 Section 15.01(3) of Rev. Proc. 2018-31 is modified to read as follows:

(3) Manner of making change.

(a) Section 481(a) adjustment.

(i) In general. A taxpayer changing its method of accounting under this section 15.01 must compute a § 481(a) adjustment. This adjustment must reflect the account receivables, account payables, inventory, and any other item determined to be necessary in order to prevent items from being duplicated or omitted. However, the adjustment does not include any item of income accrued but not received that was worthless or partially worthless (within the meaning of § 166(a)) on the last day of the year immediately prior to the year of change.

(ii) Temporary rule for certain S corporation revocations. The rules in this section 15.01(3)(a)(ii) apply to an eligible terminated S corporation, as defined in § 481(d)(2), that changes to an overall accrual method of accounting in the C

corporation's first taxable year after its revocation of its election under § 1362(a), and such revocation occurs during the two-year period beginning on December 22, 2017.

(A) Required spread period. Pursuant to § 481(d)(1), an eligible terminated S corporation required to change to an overall accrual method as a result of a revocation of its S corporation election that changes its method of accounting under this section 15.01 in the C corporation's first taxable year after such revocation, takes into account the resulting positive or negative adjustment required by § 481(a)(2) ratably during the six-year period beginning with the year of change.

(B) Optional six-year spread period. An eligible terminated S corporation that is permitted to continue to use the overall cash method after the revocation of its S corporation election, and that changes to an overall accrual method under this section 15.01 in the C corporation's first taxable year after such revocation, may take into account the resulting positive or negative adjustment required by § 481(a)(2) ratably during the six-year period beginning with the year of change instead of using the adjustment periods provided in section 7.03(1) of Rev. Proc. 2015-13. An eligible terminated S corporation that wants to use this six-year spread period must indicate in the statement required by Line 26 of Form 3115 (Rev. December 2015) that it is making the change in method of accounting with the spread period permitted under this section 15.01(3)(a)(ii)(B) on its timely filed Form 3115.

SECTION 4. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 2018-31 is modified.

SECTION 5. APPLICABILITY DATE

This revenue procedure is applicable to adjustments under § 481(a)(2) that result from an eligible terminated S corporation's change to an overall accrual method of accounting in the C corporation's first taxable year after the revocation of its election under § 1362(a), when such revocation occurs during the two-year period beginning on December 22, 2017.

DRAFTING INFORMATION

The principal author of this revenue procedure is Natasha Mulleneaux of the Office of Associate Chief Counsel (Income Tax and Accounting). For further information regarding this revenue procedure, contact Ms. Mulleneaux at (202) 317-7007 (not a toll-free call).