

examination to the specific charge-off method. One commentator noted that a taxpayer should not be changed by the IRS to the specific charge-off method merely because of unintentional and/or immaterial variances between the methods permitted under these regulations and the taxpayers' computations, which are often due to factors beyond the taxpayer's control. Among the factors noted were inherent delays between the time services were rendered and when actual billing occurs (which may affect the determination of the year-end balance of accounts receivable, especially when services are provided at the end of one taxable year and the billing occurs a few days later in the subsequent taxable year), and constraints of the taxpayer's computer systems that limit the taxpayer's ability to maintain the data necessary for a nonaccrual-experience method. For example, a taxpayer may be unable to determine whether a particular recovery relates to an account receivable on hand at the beginning of the taxable year. The commentator noted that a taxpayer may therefore choose to treat all recoveries as relating to an account receivable on hand at the beginning of the taxable year, which under safe harbor 2, reduces the nonaccrual-experience amount that the taxpayer would be entitled to if the taxpayer precisely allocated its recoveries. Because these factors generally will result in a taxpayer claiming less than the proper nonaccrual-experience amount the taxpayer would otherwise be entitled to, the commentator requested that the IRS not change a taxpayer to the specific charge-off method due to variances similar to those noted above.

The IRS and Treasury Department do not intend that a taxpayer be changed to the specific charge-off method due to unintentional and/or immaterial variances, especially if a taxpayer is disadvantaged by such variances. As a result, the temporary regulations require only that a taxpayer maintain records that are sufficient to establish the amount of any exclusion from gross income under section 448(d)(5) for the taxable year. This rule is consistent and in accordance with § 1.6001-1(a) (rules regarding records). However, the IRS maintains the right to change a taxpayer to the specific charge-off method if such taxpayer fails to maintain sufficient records to establish the amount of any claimed exclusion from gross income under section 448(d)(5) for the taxable year. The IRS and Treasury Department request comments on this record keeping standard.

#### *Periodic Systems*

Notice 88-51, 1988-1 C.B. 535, provides guidance on the use of a periodic system of applying the nonaccrual-experience method provided in former Temp. Reg. § 1.448-2T(e)(2). The periodic system entails establishing an account based on the aggregate amount of accounts receivable that: (1) Are eligible for the nonaccrual-experience method; and (2) the taxpayer estimates will not be collected. The account is adjusted each year to reflect the taxpayer's estimate (using its nonaccrual-experience method) of the aggregate amount of the accounts receivable outstanding at year-end that will not be collected. A corresponding adjustment is then made to gross income.

The IRS and Treasury Department intend to update Notice 88-51 to provide for the use of a periodic system by taxpayers using any nonaccrual-experience method. Pending the issuance of this guidance, a taxpayer may use the periodic system described in Notice 88-51 in conjunction with any permissible nonaccrual-experience method used by the taxpayer.

#### *Accounting Method Change Procedures*

A change from a nonaccrual-experience method by a taxpayer no longer qualified to use such a method, a change to a nonaccrual-experience method, a change from one nonaccrual-experience method to another nonaccrual-experience method, or a change from using one safe harbor method for self-testing to another safe harbor method, is a change in method of accounting to which the provisions of sections 446 and 481, and the regulations thereunder, apply. The temporary regulations provide, in most instances, automatic consent for these changes. Taxpayers making these changes should follow the procedures of Rev. Proc. 2002-9. Additionally, the temporary regulations provide automatic consent procedures for taxpayers changing to a nonaccrual-experience method to also request to change to a periodic system.

#### *Additional Issues to be Addressed in Final Regulations*

The IRS and Treasury Department intend to address additional issues in future guidance that are not addressed in these temporary regulations. Specifically, the IRS and Treasury Department request comments on the effect on the computation of a taxpayer's nonaccrual-experience as a result of a short taxable year, and an acquisition or disposition of an entity during a taxable

year, including the acquisition or disposition of an entity disregarded for federal income tax purposes. The IRS and Treasury Department also request comments on whether the computation under the Actual Experience Method should be based on the prior three taxable years or, as currently provided, the current taxable year and the two immediately preceding taxable years.

#### **Effect on Other Documents**

The following publication is obsolete as of September 4, 2003:

Notice 2003-12 (2003-6 I.R.B. 422).

The following publication is modified to include in section 5.06 of the Appendix as of September 4, 2003, only the changes in method of accounting provided in § 1.448-2T(g)(2)(ii), (g)(3)(i) and (h):

Rev. Proc. 2002-9 (2002-1 C.B. 327).

#### **Special Analyses**

It has been determined that these temporary regulations are not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. For application of the Regulatory Flexibility Act, please refer to the cross-reference notice of proposed rulemaking published elsewhere in this issue of the **Federal Register**. Pursuant to section 7805(f) of the Internal Revenue Code, these regulations will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact.

#### **Drafting Information**

The principal author of these regulations is Terrance McWhorter of the Office of Associate Chief Counsel (Income Tax and Accounting). However, other personnel from the IRS and Treasury Department participated in their development.

#### **List of Subjects**

##### *26 CFR Part 1*

Income taxes, reporting and recordkeeping requirements.

##### *26 CFR Part 602*

Reporting and recordkeeping requirements.

#### **Amendments to the Regulations**

■ Accordingly, 26 CFR parts 1 and 602 are amended as follows: