

(f) *Example 14* of this section for an example of this rule.

(B) *Three-year self-test.* If, as a result of the three-year self-test requirement of paragraph (e)(6)(ii) of this section, the cumulative alternative nonaccrual-experience amount for the test period is greater than the cumulative safe harbor nonaccrual-experience amount for the test period, the taxpayer's alternative nonaccrual-experience amount will be limited to the cumulative safe harbor nonaccrual-experience amount for the test period. Any excess of the taxpayer's cumulative alternative nonaccrual-experience amount over the taxpayer's cumulative safe harbor nonaccrual-experience amount excluded from income during the test period must be recaptured into income in accordance with paragraph (e)(6)(vii) of this section. The taxpayer may continue to use its alternative nonaccrual-experience method, subject to the three-year self-test requirement in paragraph (e)(6)(ii) of this section. See paragraph (f) *Example 15* of this section for an example of this rule.

(vii) *Recapture*—(1) *In general.* Any amount required to be recaptured pursuant to paragraph (e)(6)(vi)(B) of this section must be included in income in the third taxable year of the three-year self-test period. See paragraph (f) *Example 15* of this section for an example of this rule.

(7) *Special rules*—(i) *Application to specific accounts receivable.* The nonaccrual-experience method shall be applied with respect to each account receivable of the taxpayer that is eligible for such method. With respect to a particular account receivable, the taxpayer will determine, in the manner prescribed in paragraphs (e)(2) through (e)(6) of this section (whichever applies), the amount of such account receivable that is not expected to be collected. Such determination shall be made only once with respect to each account receivable, regardless of the term of such receivable. The estimated uncollectible amount shall not be recognized as gross income. Thus, the amount recognized as gross income shall be the amount that would otherwise be recognized as gross income with respect to the account receivable, less the amount which is not expected to be collected. A taxpayer that excludes an amount from income during a taxable year as a result of the taxpayer's use of a nonaccrual-experience method cannot deduct in any subsequent taxable year the amount excluded from income. Thus, the taxpayer cannot deduct the excluded amount in a subsequent taxable year in which the taxpayer actually determines that the amount is

uncollectible and charges it off. If a taxpayer using a nonaccrual-experience method determines that an amount that was not excluded from income is uncollectible and should be charged off (e.g., a calendar-year taxpayer determines on November 1st that an account receivable that was originated on May 1st of the same year is uncollectible and should be charged off) the taxpayer may deduct the amount charged off when it is charged off, but must include any subsequent recoveries in income. The reasonableness of a taxpayer's determinations that amounts are uncollectible and should be charged off may be considered on examination. See paragraph (f) *Example 16* of this section for an example of this rule.

(ii) *Charge-off.* For purposes of this section, amounts charged-off shall include only those amounts that would otherwise be allowable under section 166(a).

(iii) *Recoveries.* Regardless of the nonaccrual-experience method of accounting used by a taxpayer under this section, the taxpayer must take into account recoveries of amounts previously charged off. If, in a subsequent taxable year, a taxpayer recovers an amount previously excluded from income under a nonaccrual-experience method or charged off, the taxpayer must include the recovered amount in income in that subsequent taxable year. See paragraph (f) *Example 17* of this section for an example of this rule.

(iv) *Application of nonaccrual-experience method.* The rules of section 448(d)(5) and the regulations thereunder shall be applied separately to each taxpayer. For purposes of section 448(d)(5), the term "taxpayer" has the same meaning as the term "person" defined in section 7701(a)(1) (rather than the meaning of the term "taxpayer" defined in section 7701(a)(14)).

(v) *Record keeping requirements.* (A) A taxpayer using a nonaccrual-experience method shall keep such books and records as are sufficient to establish the amount of any exclusion from gross income under section 448(d)(5) for the taxable year, including books and records demonstrating—

(1) The nature of the taxpayer's nonaccrual-experience method;

(2) Whether, for any particular taxable year, the taxpayer qualifies to use its nonaccrual-experience method (including the self-testing requirements of paragraph (e)(6)(ii) of this section (if applicable));

(3) The taxpayer's determination that amounts are uncollectible; and

(4) The proper amount that is excludable under the taxpayer's nonaccrual-experience method.

(B) A taxpayer that does not maintain records of the data that are sufficient to establish the amount of any exclusion from gross income under section 448(d)(5) for the taxable year may be subject to being charged by the IRS on examination to the specific charge-off method. See § 1.6001-1 for rules regarding records.

(f) *Examples.* The following examples illustrate the provisions of this section. In each example, the taxpayer uses a calendar year for federal income tax purposes and an accrual method of accounting, does not require the payment of interest or penalties with respect to past due accounts receivable and, in the case of *Examples 5* through *8* and *12* through *15*, selects an appropriate determination date for each taxable year.

Example 1. Charging interest and/or penalties. A has two billing methods for the amounts to be received from A's provision of services described in paragraph (a)(1) of this section. Under one method, for amounts that are more than 90 days past due, A charges interest at a market rate until such amounts (together with interest) are paid. Under the other billing method, A charges no interest for amounts past due. Pursuant to paragraph (c) of this section, A may not use a nonaccrual-experience method of accounting with respect to any of the amounts billed under the method that charges interest on amounts that are more than 90 days past due. A may, however, use the nonaccrual-experience method with respect to the amounts billed under the method that does not charge interest for amounts past due.

Example 2. Contractual allowance or adjustment. B, a healthcare provider, performs a medical procedure on individual C, who has health insurance coverage with IC, an insurance company. B bills IC and C for \$5,000, B's standard charge for this medical procedure. However, B has a contract with IC that obligates B to accept \$3,500 as full payment for the medical procedure if the procedure is provided to a patient insured by IC. Under the contract, only \$3,500 of the \$5,000 billed by B is legally collectible from IC and C. The remaining \$1,500 represents a contractual allowance or contractual adjustment. Thus, pursuant to paragraph (d)(2) of this section, the remaining \$1,500 is not a contractually collectible amount for purposes of this section and B may not use a nonaccrual-experience method with respect to this portion of the accounts receivable.

Example 3. Charitable or pro bono services. D, a law firm, agrees to represent individual E in a legal matter and to provide services to E on a pro bono basis. D normally charges \$500 for these services. Because D performed its services to E pro bono, D's services were never billed or intended to result in revenue. Thus, pursuant to paragraph (d)(2) of this section, the \$500 forgone legal fee is not a