Changes in Annual Accounting Period

Notice 2002–72

SECTION 1. PURPOSE

This notice clarifies and modifies certain provisions in Rev. Proc. 2002–37, 2002–22 I.R.B. 1030, Rev. Proc. 2002–38, 2002–22 I.R.B. 1037, and Rev. Proc. 2002–39, 2002–22 I.R.B. 1046, which provide procedures for obtaining approval of an adoption, change, or retention of an annual accounting period. Specifically, this notice provides that:

1) certain entities with required taxable years that must concurrently change their annual accounting period as a term and condition for the approval of a related taxpayer's change of annual accounting period must do so under the applicable automatic approval procedures notwithstanding any limitations in those procedures to the contrary or any conflicting testing date provisions;

2) the Internal Revenue Service will not apply the rule in section 5.06 of Rev. Proc. 2002–38, under which less than 100% ownership of an S corporation by a tax-exempt entity is disregarded for purposes of determining the S corporation's ownership taxable year, to require any S corporation to change its annual accounting period in any taxable year beginning before January 1, 2003;

3) a partnership that is allowed, under section 4.01(5) of Rev. Proc. 2002–38, to retain its current taxable year for one year in the case of a minor, temporary percent change in ownership may also apply to retain its current year, or to change to any other taxable year for which it can establish a business purpose, under Rev. Proc. 2002–38 or Rev. Proc. 2002–39, whichever is applicable;

4) an interest in a pass-through entity that does not meet section 4.02(2)(c) of Rev. Proc. 2002–37 may still be disregarded under the *de minimis* test in section 4.02(2)(d) of that revenue procedure;

5) the filing instructions in section 7.02 of Rev. Proc. 2002–37 for a corporate United States shareholder completing and filing a Form 1128, *Application to Adopt, Change, or Retain a Tax Year*, on behalf of a controlled foreign corporation (CFC) or a foreign personal holding company (FPHC) apply as well to a non-corporate United States shareholder; and

6) the exception to the terms and conditions provided in each of the revenue procedures respecting record keeping and book conformity pertains to books and records kept for financial statement, and not tax, purposes.

SECTION 2. BACKGROUND

Rev. Proc. 2002–37 provides the exclusive procedures for certain corporations within its scope to obtain automatic approval to change their annual accounting periods under § 442 of the Internal Revenue Code and § 1.442–1(b) of the Income Tax Regulations.

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

Rev. Proc. 2002–39 provides the general procedures for taxpayers not within the scope of either Rev. Proc. 2002–37 or Rev. Proc. 2002–38 to establish a business purpose and obtain the prior approval of the Commissioner to adopt, change, or retain an annual accounting period.

Questions have arisen as to the scope and intent of certain provisions of these revenue procedures. Additionally, the Service and Treasury Department have determined that it is in the best interest of sound tax administration that the application of the ownership tax year rule found in section 5.06 of Rev. Proc. 2002–38 be delayed.

SECTION 3. APPLICATION

A. *Concurrent Changes by Related Entities*

A change in annual accounting period by an entity that must concurrently change its annual accounting period as a term and condition of another taxpayer's annual accounting period change under either section 6.10 of Rev. Proc. 2002–37 or section 5.04(8) of Rev. Proc. 2002–39, must be made under the applicable automatic revenue procedure notwithstanding any conflicting testing date provisions under §§ 706(b)(4)(A)(ii), 898(c)(1)(C)(ii), § 1.921–1T(b)(6), and the special provision in § 706(b)(4)(b). If the entity that is required to change is a corporation, such as a CFC, it is deemed to be within section 4.01 of Rev. Proc. 2002–37, and if it is a pass-through entity, such as a partnership, it is deemed to be within section 4.01(1) of Rev. Proc. 2002–38. The preceding sentence applies notwithstanding any conflicting testing date provision under the Code or regulations or any other limitation under section 4.02 of Rev. Proc. 2002–37 or section 4.02 of Rev. Proc. 2002–38.

B. *Ownership Taxable Year of Certain S Corporations*

Section 5.06 of Rev. Proc. 2002–38 (relating to the definition of an "ownership taxable year") provides that, under principles similar to the principles set forth in § 1.706–3T for determining the taxable year of a partnership, a shareholder that is tax-exempt under § 501(a) is disregarded if such shareholder is not subject to tax on any income attributable to the S corporation. The Service will not apply this rule to require an S corporation to change its taxable year for any taxable year beginning before January 1, 2003.

C. *Certain changes in ownership of partnerships*

Section 4.01(5)(B) of Rev. Proc. 2002–38 is modified to read as follows:

* * *

"(B) it is reasonably foreseeable that, at the end of one taxable year, the change in ownership will be reversed. If, at the end of one taxable year, the partnership's current taxable year does not meet section 4.01(1) of this revenue procedure, then the partnership must change to its required taxable year under section 4.01(1), or apply to either retain its current taxable year or change to any other taxable year for which it can establish a business purpose, under this revenue procedure or Rev. Proc. 2002–39, whichever is applicable."

D. *De mimimis Test for Interest in Pass-through Entities*

Section 4.02(2)(d) of Rev. Proc. 2002–37 is modified to read as follows:

* * *

"for pass-through entities not qualifying for the exceptions in section 4.02(a), 4.02(b), or 4.02(c) of this revenue procedure, the pass-through entity in which the corporation has an interest has been in existence for at least 3 taxable years and the interest is *de minimis*. For this purpose, an interest in a pass-through entity is *de minimis* only if:”

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E. *Filing Requirements for Period Changes by CFCs and FPHCs*

Any United States shareholder (including a non-corporate United States shareholder) completing and filing a Form 1128 on behalf of a CFC or FPHC must file the Form 1128 where the United States shareholder files the shareholder’s federal income tax return.

F. *Record Keeping/Book Conformity*

The common term and condition in Rev. Proc. 2002–37 (section 6.04), Rev. Proc. 2002–38 (section 6.04), and Rev. Proc. 2002–39 (section 5.04(3)) relating to record keeping and book conformity is clarified to remove any implication or inference that books and records maintained for tax purposes need not be kept on the basis of the requested taxable year. Taxpayers are reminded that their books and records for United States federal income tax purposes must in all circumstances be kept on the basis of their approved annual accounting period, regardless of whether the taxpayer comes within one of the two exceptions to the term and condition pertaining to financial books and records.

SECTION 4. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 2002–37, Rev. Proc. 2002–38, and Rev. Proc. 2002–39 are clarified and modified.

SECTION 5. EFFECTIVE DATE

The provisions of this notice are effective as if originally included in Rev. Proc. 2002–37, Rev. Proc. 2002–38, and Rev. Proc. 2002–39.

DRAFTING INFORMATION

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