

MEMO# 20993

March 26, 2007

IRS Issues Guidance Regarding Accrual of Liabilities for Services and Insurance; Conference Call Scheduled for April 3, 2007

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TO: TAX COMMITTEE No. 10-07 RE: IRS ISSUES GUIDANCE REGARDING ACCRUAL OF LIABILITIES FOR SERVICES AND INSURANCE; CONFERENCE CALL SCHEDULED FOR APRIL 3, 2007

The IRS has released Revenue Ruling 2007-3 (2007-4 I.R.B. 350) and Revenue Procedure 2007-14 (2007-4 I.R.B. 357)(both attached), which address the accrual of liabilities for services or insurance under section 461 of the Internal Revenue Code and related accounting method changes. A conference call is scheduled for Tuesday, April 3, 2007 at 2:00 p.m. (eastern time) to discuss the guidance. If you would like to participate in the call, please complete the attached response form and send it to Ezella Wynn at 202-326-5841 (fax) or ewynn@ici.org by close of business Monday, April 2, 2007. To access the call, please dial 800-857-6553 and enter passcode 34098.

Rev. Rul. 2007-3 analyzes two situations under the “all events test” and the “recurring item exception,” rules that determine when a liability is incurred for tax purposes under an accrual method of accounting. In Situation 1, the taxpayer executes a contract with a service provider on December 15, 2006 for services to begin and payment due on January 15, 2007. In Situation 2, the taxpayer executes a contract with a state-regulated insurance company on December 15, 2006 for insurance; the contract provides that insurance coverage begins and payment is due on January 15, 2007.

Rev. Rul. 2007-3 provides that under section 461, all the events have occurred that establish the fact of a taxpayer's liability for services or insurance on the earlier of when (1) the event fixing the liability, whether that be the required performance or another event, occurs, or (2) payment is due. In both Situations 1 and 2, the payment due date of January 15, 2007 is the first event that fixes the taxpayer's liability and determines that 2007 is the year that the liability is incurred for tax purposes. The recurring item exception does not apply to accrue the liability in 2006 because the fact of the liability is not established in 2006 when the taxpayer executed the contract. The ruling provides that the execution of a contract is not sufficient, by itself, to establish liability.

A change in the treatment of liabilities for services or insurance to comply with Rev. Rul. 2007-3 is a change in method of accounting requiring the consent of the Commissioner under section 446. Revenue Procedure 2007-14 sets forth procedures for a taxpayer to obtain an automatic consent from the Commissioner to change its method of accounting to comply with Rev. Rul. 2007-3.

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