

MEMO# 17104

February 19, 2004

CHANGE IN ACCOUNTING METHOD PROCEDURES UNDER FINAL CAPITALIZATION REGULATIONS

[17104] February 19, 2004 TO: TAX MEMBERS No. 9-04 ACCOUNTING/TREASURERS MEMBERS No. 7-04 ADVISER DISTRIBUTOR TAX ISSUES TASK FORCE No. 3-04 RE: CHANGE IN ACCOUNTING METHOD PROCEDURES UNDER FINAL CAPITALIZATION REGULATIONS As we have previously informed you, the final regulations on the capitalization of intangible assets (the "Regulations") include provisions granting the Commissioner's consent to a change in accounting method to comply with the final regulations.¹ This automatic consent is available for the taxpayer's first taxable year ending on or after December 31, 2003, provided the taxpayer follows the administrative procedures for obtaining automatic consent. The Service has indicated that it intends to issue further guidance on obtaining automatic consent under these provisions in the future. Generally, a taxpayer intending to obtain automatic consent for a change must file a completed Form 3115 with its timely filed (including extensions) tax return for the year of change (as well as a duplicate copy with the National Office by the same date). There is no fee for filing for an automatic change, and the Regulations do not limit who may file for an automatic change (e.g., being under examination is no bar to filing), but late forms will not be accepted except in "unusual or compelling circumstances." The Regulations generally impose a "modified cut-off" transition rule.² Under this approach, a taxpayer who changed its method of accounting for its first taxable year ending on or after December 31, 2003, would make an adjustment for all amounts paid or incurred in tax years ending on or after January 24, 2002. Thus, in the case of distributor commissions, a taxpayer changing its method of accounting would include in its Section 481(a) adjustment unamortized commissions from tax years 2002 and 2003, but would continue to amortize any commissions incurred in tax year 2001. Under Rev. Proc. 2002-9, as amended by Rev. Proc. 2002-19, the general rule is that a net negative (i.e., taxpayer-favorable) Section 481(a) adjustment is taken entirely in the year of the change.³ 1 See Institute Memorandum to Tax Members No. 68-03, Accounting/Treasurers Members No. 63-03, and Adviser Distributor Tax Issues Task Force No. 19-03 [16924], dated December 30, 2003. 2 With regard to pooling methods, the Regulations impose a cut-off method. 3 A net positive adjustment is taken over four taxable years. 2 The requirement to file for an automatic consent applies to any change in accounting method authorized under the final regulations, such as treatment of distributor commissions and fund start-up expenses (including employee compensation). David Orlin Assistant Counsel

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