

26 CFR 601.204: Changes in accounting period and in methods of accounting.
(Also Part 1, §§ 166, 446, 481, 585, 1362, 1374; 1.446-1, 1.1374-4)

Rev. Proc. 97-18

SECTION 1. PURPOSE

This revenue procedure provides guidance for any bank as defined in § 581 of the Internal Revenue Code (except any large bank as defined in § 585(c)(2)) that seeks to change its method of accounting for bad debts from the § 585 reserve method to the § 166 specific charge-off method so that it may elect S corporation status for the tax year beginning in 1997.

SECTION 2. BACKGROUND

.01 Section 1315 of the Small Business Job Protection Act of 1996, Pub. L. No. 104-188, 110 Stat. 1755, amended § 1361(b)(2) to allow banks (as defined in § 581) that do not use the reserve method of accounting for bad debts to qualify as small business corporations (and therefore qualify to elect S corporation status), effective for tax years beginning after December 31, 1996.

.02 Notice 97-5, 1997-2 I.R.B. 25, states that the Service will issue additional guidance granting permission for an automatic change in method of accounting for banks that change from the reserve method of accounting.

.03 Except as otherwise expressly provided, a bank must obtain the consent of the Commissioner of Internal Revenue to change a method of accounting for federal income tax purposes. To obtain this consent, a Form 3115 (Application for Change in Accounting Method) generally must be filed within 180 days after the beginning of the tax year in which the proposed change is to be made. Section 446(e) and § 1.446-1(e)(2)(i) and (3)(i) of the Income Tax Regulations.

.04 The Commissioner is authorized to prescribe administrative procedures setting forth the limitations, terms, and conditions the Commissioner deems necessary to obtain consent for effecting a change in method of accounting and to prevent amounts from being duplicated or omitted, including the tax year

or years in which the § 481(a) adjustment is to be taken into account. Section 1.446-1(e)(3)(ii).

.05 In computing taxable income, § 481(a) requires a bank to take into account those adjustments necessary to prevent amounts from being duplicated or omitted when the bank's taxable income is computed under a method of accounting different from the method used to compute taxable income for the preceding tax year.

SECTION 3. SCOPE

This revenue procedure applies to any bank as defined in § 581 (except any large bank as defined in § 585(c)(2)) that seeks to change its method of accounting for bad debts from the § 585 reserve method to the § 166 specific charge-off method, effective for its first tax year beginning after December 31, 1996 (1997 tax year), in order to elect S corporation status for its 1997 tax year.

SECTION 4. AUTOMATIC PROCEDURE

.01 A bank, to which this revenue procedure applies, that elects under § 1362 to become an S corporation by filing a Form 2553 (Election by a Small Business Corporation) effective for its 1997 tax year will be deemed to have elected to change its method of accounting for bad debts from the § 585 reserve method to the § 166 specific charge-off method effective for its 1997 tax year (year of change) and to have agreed to all the terms and conditions of this revenue procedure.

.02 The bank must file a Form 2553 within the first 2 months and 15 days of the first day of its 1997 tax year for the S corporation election to be effective for its 1997 tax year.

.03 In accordance with § 1.446-1(e)(3)(ii), the requirement to file an application on Form 3115 within the 180-day period provided in § 1.446-1(e)(3)(i) is waived for any application for change in method of accounting filed pursuant to this revenue procedure. In addition, under § 1.446-1(e)(2)(i), the consent of the Commissioner is hereby granted to any bank within the scope of this revenue procedure to change its method of accounting for bad debts, in accordance with this revenue procedure, from the § 585 reserve method to the § 166 specific charge-off method for the bank's 1997 tax year.

.04 A bank that uses this revenue procedure to change its method of ac-

counting for bad debts from the § 585 reserve method to the § 166 specific charge-off method may not later use Rev. Proc. 85-8, 1985-1 C.B. 495, to return to the § 585 reserve method.

.05 A bank changing its method of accounting under this revenue procedure also must file a Form 3115 in duplicate. The original Form 3115 must be attached to the bank's timely filed (including extensions) S corporation federal income tax return for its 1997 tax year. In addition, a copy of the Form 3115 must be filed with the national office addressed to the Commissioner of Internal Revenue, Attention: Office of Assistant Chief Counsel (Financial Institutions and Products) CC:DOM:FI&P, P.O. Box 7604, Benjamin Franklin Station, Washington, D.C. 20044, no later than the date the original Form 3115 is filed with the 1997 S corporation federal income tax return. No user fee is required for a Form 3115 filed under this revenue procedure. A Form 3115 filed pursuant to this revenue procedure will not be acknowledged.

.06 In addition to the filing requirements in section 4.05 of this revenue procedure, a bank that is under examination at any time between February 19, 1997, and the due date for filing its original federal income tax return (including extensions) for its 1997 tax year must provide a copy of the Form 3115 to the examining agent no later than the earlier of (i) 180 days after February 19, 1997, or for a bank that is not under examination on February 19, 1997, 180 days after the bank first comes under examination, or (ii) the date the bank must file its original federal income tax return (including extensions) for its 1997 tax year.

SECTION 5. SECTION 481(a) ADJUSTMENT

.01 As a condition of the change in method of accounting under this revenue procedure, a bank must include the amount of its § 481(a) adjustment in its income, beginning with its 1997 tax year, ratably over the lesser of 6 years or the number of years that the bank has used the § 585 reserve method. See section 5.04 and 5.05 for exceptions to the § 481(a) adjustment period.

.02 Generally, the amount of a bank's § 481(a) adjustment for a change in method of accounting under this revenue procedure is the amount of the bank's reserve for bad debts as of the close of the tax year immediately before the year

of change. However, the amount of the § 481(a) adjustment does not include the amount of a bank's pre-1988 reserves (as described in § 593(g)(2)(A)-(ii), without taking into account § 593(g)(2)(B)) if the bank changed in a prior year from the § 593 reserve method to the § 585 reserve method and § 593(g) applied to that change. The § 481(a) adjustment is recognized built-in gain under § 1374. See § 1.1374-4(d). In addition, banks should be aware of the effects of the interaction between provisions specially applicable to banks and provisions of subchapter S, for example, (i) §§ 593(e) and 1368 with respect to earnings and profits, and (ii) §§ 593(e) and (g)(3) and 1374.

.03 A change in method of accounting under this revenue procedure shall be treated as a voluntary change in method of accounting that is initiated by the bank; and therefore, the § 481(a) adjustment is not restricted to post-1953 items.

.04 A bank may elect to use a one-year § 481(a) adjustment period if its entire § 481(a) adjustment is less than \$25,000. A bank that desires to elect this one-year adjustment period must so indicate by checking the "Yes" box in Question 26 on its Form 3115 and must include the entire § 481(a) adjustment in its income for the 1997 tax year.

.05 A bank taking a § 481(a) adjustment into account under this revenue procedure that ceases being a bank as defined in § 581 must include in its income for the tax year of the cessation any remaining balance of the § 481(a) adjustment.

SECTION 6. AUDIT PROTECTION FOR CHANGE IN METHOD OF ACCOUNTING

.01 A bank within the scope of this revenue procedure that timely complies with all of the terms and conditions of this revenue procedure will have audit protection (that is, the district director may not propose that the bank change the same method of accounting as the method that the bank is changing under this revenue procedure) for tax years before 1997 unless (1) the bank has received written notification from an examining agent (for example, by examination plan, information document request, notification of proposed adjustments or income tax examination changes) before February 19, 1997, specifically citing as an issue under consid-

eration the bank's reserve method of accounting for bad debts, or (2) the bank's reserve method of accounting for bad debts was an issue under consideration by an appeals office or a federal court before February 19, 1997.

.02 The district director, however, will verify the amount of the § 481(a) adjustment and the § 481 adjustment period, and otherwise determine that the bank has fully complied with this revenue procedure.

SECTION 7. EXCLUSIVE PROCEDURE

.01 This revenue procedure is the exclusive procedure available to a bank within the scope of this revenue procedure to obtain the Commissioner's consent to change its method of accounting for bad debts from the § 585 reserve method to the § 166 specific charge-off method. Any Form 3115 filed with the national office under Rev. Proc. 92-20, 1992-1 C.B. 685, by a bank that is within the scope of this revenue procedure, along with any user fee submitted, will be returned to the bank.

.02 The national office or district director may review a bank's Form 3115 filed under this revenue procedure. If it is determined that the bank does not qualify for the change in method of accounting under this revenue procedure, the national office or the district director will so advise the bank.

SECTION 8. FAILURE TO COMPLY

A bank to which this revenue procedure applies that changes its method of accounting for bad debts without complying with all of the applicable provisions of this revenue procedure will be deemed to have initiated the change without obtaining the consent of the Commissioner as required by § 446(e) and will not have audit protection for prior years as provided in section 6. Accordingly, the district director may propose to change the bank's reserve method in a prior year, and if the first year in which the bank improperly uses the requested method of accounting is no longer open for the assessment of a deficiency of tax, the Commissioner may use the Commissioner's statutory discretion to change the bank's method of accounting in a later year and impose an adjustment under § 481(a).

SECTION 9. DEFINITIONS

Except as otherwise provided in this revenue procedure, the following terms have the meaning given to them by Rev. Proc. 92-20:

Under examination (See section 3.02 of Rev. Proc. 92-20);

Year of change (See section 3.03 of Rev. Proc. 92-20); and

Filed (See section 3.04 of Rev. Proc. 92-20).

SECTION 10. EFFECT ON OTHER REVENUE PROCEDURES

Rev. Proc. 85-8, 1985-1 C.B. 495, is modified.

SECTION 11. EFFECTIVE DATE

This revenue procedure is effective only for accounting method changes by a bank for which the 1997 tax year is the year of change.

DRAFTING INFORMATION

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