INTERNAL REVENUE SERVICE
NATIONAL OFFICE TECHNICAL ADVICE MEMORANDUM
December 14, 2000

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District Director

Taxpayer's Name:
Taxpayer's Address:

Taxpayer's Identification No:
Years Involved:
Date of Conference:

LEGEND:

Taxpayer =

process =

a =

b =

c =

d =

e =

f =

g =

h =

Year 1 =

Year 7 =

Year 9 =

Year 13 =

Year 14 =

ISSUE(S):

1. Whether an information document request (IDR) issued during the planning stage of an examination, which specifically identifies an accounting method or sub-method as an area of potential adjustment, constitutes written notification that the method or sub-method is an issue under consideration in the subsequent examination.

2. Whether a broad statement in an IDR renders the entire IDR invalid for purposes of placing an issue under consideration, even when the IDR contains other statements that are specific.

3. If the entire IDR is not rendered invalid, whether Taxpayer received written notification prior to filing its Form 3115, Application for Change in Accounting Method, that specifically cited the method that was the subject of the Form 3115 as an issue under consideration in the subsequent examination.

CONCLUSION:

1. An IDR issued during the planning stage of examination, which specifically identifies an accounting method or sub-method as an area of potential adjustment, constitutes written notification that the method or sub-method is an issue under consideration in the subsequent examination.

2. A broad statement in an IDR does not invalidate the entire IDR when the IDR contains other statements that are specific.

3. Taxpayer received written notification prior to filing its Form 3115 that specifically cited the method that was the subject of the Form 3115 as an issue under consideration in the subsequent examination.

FACTS:

Taxpayer is a corporation that produces a products from b. The a products that result from the processing of b include c, d, e, f, g, and h. Taxpayer uses the overall accrual method of accounting based on a calendar taxable year and the dollar-value last-in first-out (LIFO) method of inventory accounting. Taxpayer first elected the LIFO inventory method for its Year 1 tax year.

During Year 13, the Service studied the LIFO item definition[1] that was being utilized in the a industry. In public forums, the Service made the industry aware of its intentions to focus on this issue in future examinations.

In the last quarter of Year 13, Taxpayer began considering whether it properly differentiated quantities of b, c, d, e, f, g, and h in its inventories. As a result, Taxpayer questioned whether its existing method of defining items under the dollar-value LIFO method satisfied the clear reflection of income standard or whether it should file a Form 3115 to request a change in its method of defining items. Taxpayer began modeling different dollar-value LIFO item definitions to determine the financial and tax effects of the different definitions.

As a taxpayer subject to the coordinated examination program (CEP), Taxpayer is continually under audit. Therefore, in order for Taxpayer to voluntarily change a method of accounting it generally must file an application (Form 3115) during one of the periods, or "windows," that are provided under section 6 of Rev. Proc. 92-20, 1992-1 C.B. 685.[2] On January 1, Year 14, a 30-day window period (January 1, Year 14 - January 30, Year 14) opened for Taxpayer, during which it could have filed an application to change its dollar-value LIFO item definition. However, Taxpayer asserts that it was unable to file an accurate application during this window due to the complexity of the task, the demands of year-end closings, and a reduced workforce during the holidays. Instead, Taxpayer asserts that it decided to file an accurate Form 3115 when its next window opened. Taxpayer anticipated that its next window would open when the examination of its Year 7 - Year 9 tax years ended. Taxpayer further anticipated that it would receive a 30-day letter for the Year 7 - Year 9 tax years sometime during late January Year 14. On January 31, Year 14, Taxpayer received a 30-day letter.

From February Year 14 until May Year 14, Taxpayer devoted time and resources to determine the proper number of items for its a and processed products pools. During this time, Taxpayer met numerous times with its accountants to discuss the project's progress and difficulties. On March 10, Year 14, Taxpayer hired an outside accounting

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[1]The LIFO method is designed to eliminate the profits attributable to inflation from the current period income calculation. To properly reflect increases attributable to inflation, the goods contained in a taxpayer's item categories must have similar characteristics, because a "system which groups like goods together and separates dissimilar goods permits cost increases attributable to inflation to be isolated and accurately measured." Hamilton Indus., Inc. & Sub. v. Commissioner, 97 TC 120, 132 (1997).

[2]For Forms 3115 filed on or after May 15, 1997, Rev. Proc. 92-20 has been modified and superceded by Rev. Proc. 97-27, 1997-1 C.B. 680.

firm to perform an in-depth analysis concerning its dollar-value LIFO item definition. Taxpayer asserts that the outside accounting firm spent hundreds of hours on the project.

On March 13, Year 14, Taxpayer received an IDR from Exam for the development of an examination plan. This IDR read as follows:

> Pursuant to sections 6.03 and 6.04 of Revenue Procedure 92-20, the Service hereby notifies you that it has identified the following LIFO accounting methods that are areas of potential adjustment:
>
> 1. The dollar-value method used in determining the taxpayer's LIFO inventories in tax years subsequent to the tax year Year 9.
>
> 2. The method used by the taxpayer in costing its LIFO inventories.
>
> 3. The method used by the taxpayer in the pooling of its LIFO inventory items/products under the dollar-value LIFO method.
>
> 4. The method used by the taxpayer in determining the number and composition of its inventory pools.
>
> 5. The method used by the taxpayer in classifying and identifying items of inventory products.
>
> 6. The method used by the taxpayer in determining "new items" entering the inventories.
>
> 7. The double extension method used by the taxpayer in computing its base year and current year cost of its double extension inventories.

On May 6, Year 14, a 120-day window opened for Taxpayer when it filed a protest to the 30-day letter. On May 13, Year 14, the National Office received a Form 3115 from Taxpayer. In its Form 3115, Taxpayer requested permission to change its method of defining items under the dollar-value LIFO method. Taxpayer's requested change relates to its method of defining items of b, c, d, e, f, g, and h. Taxpayer also requested to establish the year of change as its new base year.

On June 2, Year 14, the National Office sent Taxpayer a letter, which tentatively determined that Taxpayer's Form 3115 did not meet the requirements of section 6.03, Rev. Proc. 92-20. The National Office's tentative determination was based on the examining agent's representation that Taxpayer had received an IDR, prior to filing its Form 3115, that placed its method of defining LIFO items under consideration.

However, the letter also indicated that any question as to whether the method or sub-method requested to be changed was an issue under consideration could be referred to the National Office as a request for technical advice.

Taxpayer subsequently requested that the question of whether its method of defining items under the dollar-value LIFO method be referred to the National Office for technical advice. In the request for technical advice, Taxpayer argues that the IDR in question did not specifically cite the accounting method or sub-method that Taxpayer is seeking to change as an issue under consideration. Taxpayer argues that the IDR cannot specifically identify any of its LIFO accounting methods or sub-methods because the IDR was issued during the planning stage of the examination and, therefore, the examining agent had not performed substantive work to identify any improprieties or deficiencies in those methods or sub-methods. Taxpayer also argues that the IDR does not place any issues under consideration because it contains several broad statements that, when taken together, encompass all of the methods and sub-methods that are used by any taxpayer accounting for inventories under the dollar-value LIFO method.

LAW AND ANALYSIS:

Section 446(e) of the Internal Revenue Code and section 1.446-1(e)(2)(i) of the Income Tax Regulations state that, except as otherwise expressly provided, a taxpayer must obtain the Commissioner's permission before changing a method of accounting for federal income tax purposes.

When Taxpayer filed its Form 3115, Rev. Proc. 92-20 provided the general procedures for taxpayers seeking the consent of the Commissioner to change a method of accounting. Under Rev. Proc. 92-20, a taxpayer ordinarily must file a Form 3115 to obtain the Commissioner's consent for an accounting method change. The time when a taxpayer may file a Form 3115 depends upon whether or not the taxpayer is under examination. A taxpayer not under examination may generally file a Form 3115 any time during the first 180 days of the taxable year of change. See section 5, Rev. Proc. 92-20. In comparison, a taxpayer under examination generally may only file a Form 3115 within certain "window periods." See section 6, Rev. Proc. 92-20. One such window period is the "120-day window period" provided in section 6.03 of Rev. Proc. 92-20.

Section 6.03 of Rev. Proc. 92-20 provides that a taxpayer under examination that desires to change any method of accounting may request a change in accounting method during the 120-day period following the date an examination ends (the "120-day

window"), even though a subsequent examination may have commenced.[3] However, this section also provides that the 120-day window will not be available when the taxpayer has received written notification from the examiner(s) (e.g., by examination plan, information document request, notification of proposed adjustments or income tax examination changes) prior to the filing of the Form 3115 specifically citing the method or sub-method to be changed as an issue under consideration for a taxable year in the subsequent examination. See section 6.03(1), Rev. Proc. 92-20.

Taxpayer's argument that an IDR issued during the planning stage of an examination cannot place an issue under consideration because the agent has not yet identified deficiencies in the accounting method is unfounded. Section 6.03 provides that the written notification issued by the examiner can take the form of an examination plan. Furthermore, although Rev. Proc. 92-20 does not define the phrase "under consideration", the phrase is commonly understood to mean that an item will receive weight or be taken into account when formulating either an opinion or a plan.[4] Thus, a particular method of accounting may be an issue under consideration before the examiner determines that it is improper or deficient in some respect. Accordingly, section 6.03 clearly contemplates that an examining agent can place an issue under consideration during the planning stage of an examination and prior to the examining agent performing substantive work to identify deficiencies in a specific accounting method.

For Forms 3115 filed on or after May 15, 1997, Rev. Proc. 97-27 provides the procedures for taxpayers seeking the consent of the Commissioner to change a method of accounting. Like Rev. Proc. 92-20, Rev. Proc. 97-27 provides that a taxpayer may file a Form 3115 to request a change in accounting method during the 120-day period following the date an examination ends ("120-day window") regardless of whether a subsequent examination has commenced. However, as in Rev. Proc. 92-20, the 120-

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[3]For purposes of Rev. Proc. 92-20, an examination of a taxpayer is considered to end at the earliest of the date: (1) the taxpayer (or consolidated group of which the taxpayer is a member) receives a "no change" letter; (2) the taxpayer (or consolidated group of which the taxpayer is a member) pays the deficiency (or proposed deficiency); (3) the taxpayer (or consolidated group of which the taxpayer is a member) requests consideration by an appeals officer; (4) the taxpayer (or consolidated group of which the taxpayer is a member) requests consideration by a federal court; or (5) on which a deficiency, jeopardy, termination, bankruptcy, or receivership assessment is made. See section 3.02, Rev. Proc. 92-20.

[4]Generally, the term "under" is defined as "receiving or undergoing the action or effect of." See Webster's Ninth New Collegiate Dictionary, 1285 (1984). The term "consideration" is generally defined as, "a matter weighed or taken into account when formulating an opinion or plan." Id., at 280.

day window is not available if the method of accounting the taxpayer is requesting to change is an issue under consideration at the time the Form 3115 is filed. See section 6.03, Rev. Proc. 97-27. For purposes of Rev. Proc. 97-27, a taxpayer's method of accounting for an item is an issue under consideration for the taxable years under examination if the taxpayer receives written notification (for example, by examination plan, information document request (IDR), or notification of proposed adjustment or income tax examination changes) from the examining agent(s) specifically citing the treatment of the item as an issue under consideration. See section 3.08(1), Rev. Proc. 97-27.

To further clarify whether an issue is "under consideration," Rev. Proc. 97-27 provides two examples. In the first example, a taxpayer's method of pooling under the dollar-value LIFO inventory method is an issue under consideration as a result of an examination plan that identifies LIFO pooling as a matter to be examined. In the second example, a taxpayer's method of determining inventoriable costs under section 263A is an issue under consideration as a result of an IDR that requests documentation supporting the costs included in inventoriable costs. These examples also clearly demonstrate that an examining agent can place an issue under consideration during the planning stage of an examination and before the examining agent has identified any impropriety or deficiency in the method to be examined.

Finally, Rev. Proc. 92-20's procedures were designed to encourage prompt compliance with proper tax accounting principles, and to discourage taxpayers from delaying the filing of applications for accounting method changes. See section 1, Rev. Proc. 92-20. Examiners and CEP taxpayers often work together in developing an examination plan, and the examination plan is often shared with the CEP taxpayer at the beginning of the examination. Allowing taxpayers to voluntarily change methods of accounting after they have had an opportunity to peruse the examination plan would encourage taxpayers to wait until they were notified of the contents of the examination plan before requesting accounting method changes. Thus, allowing an examining agent to place an issue under consideration during the planning stage encourages taxpayers to file accounting method change requests prior to being notified that the issue will be examined.

The foregoing considerations clearly establish that an examining agent can place an issue under consideration during the planning stage of an examination. Accordingly, an IDR issued during the planning stage of an examination that specifically identifies an accounting method or sub-method as an area of potential adjustment constitutes written notification that the method or sub-method is an issue under consideration in the subsequent examination.

Taxpayer also argues that the entire IDR is invalid for purposes of section 6.03 of Rev. Proc. 92-20 because the IDR contains broad statements that lack specificity. Taxpayer further argues that an IDR that contains vague or broad statements should be

invalidated *in toto*. We disagree.

Section 6.03(1) of Revenue Procedure 92-20 provides that an examining agent only places an accounting method or sub-method under consideration if the examining agent has sent the taxpayer written notification that specifically cites the method or sub-method as an issue under consideration. As stated above, the procedures of Rev. Proc. 92-20 were designed to encourage prompt compliance with proper tax accounting principles and to discourage taxpayers from delaying the filing of applications for accounting method changes. The written notification and specificity requirements in section 6.03(1) encourage voluntary compliance by ensuring that a taxpayer is aware of the accounting methods and sub-methods the taxpayer is permitted and not permitted to change during a window period. As a result, the written notification and specificity requirements help to avoid or minimize disputes between taxpayers and examining agents over whether the taxpayer was entitled to file a Form 3115 during the window period for a specific accounting method change. Therefore, the notification should fairly inform the taxpayer of the accounting method or sub-method that will be examined.

Rev. Proc. 92-20 does not contain any examples that illustrate the specificity requirement of section 6.03, but Rev. Proc. 97-27 contains a nearly identical definition of issue under consideration and provides two examples to illustrate the specificity requirement. In the first example, a taxpayer's method of pooling under the dollar-value LIFO inventory method is an issue under consideration as a result of an examination plan that identifies LIFO pooling as a matter to be examined, but would not be considered an issue under consideration if the examination plan merely identifies LIFO inventories as a matter to be examined. In the second example, a taxpayer's method of determining inventoriable costs under section 263A is an issue under consideration as a result of an IDR that requests documentation supporting the costs included in inventoriable costs, but is not an issue under consideration if the IDR requests documentation supporting the amount of costs of goods sold reported on the return.

Although the examples contained in section 3.08(1) of Rev. Proc. 97-27 do not explicitly answer the question presented by this case – whether a broad statement that does not place an issue under consideration renders ineffective a specific statement that would place an issue under consideration, the LIFO example provides some insight into the issue. In the second part of the LIFO example, the revenue procedure states that "LIFO pooling is not an issue under consideration as a result of an examination plan that merely identifies LIFO inventories as a matter to be examined." (Emphasis added). The example's use of the term "merely" indicates that statements referring to "LIFO inventories" could be supplemented with more specific statements. Accordingly, we will examine the entire written notification, reading each statement in context, to determine whether the taxpayer has been informed that a specific accounting method or sub-method will be examined.

> Opening Statement: "Pursuant to sections 6.03 and 6.04 of Revenue Procedure 92-20, the Service hereby notifies you that it has identified the following LIFO accounting methods that are areas of potential adjustment."

This statement simply informs the taxpayer that the Service is planning to examine certain of the taxpayer's LIFO accounting methods. This statement, by itself, does not place any of Taxpayer's methods of accounting under consideration because it does not specifically identify a LIFO method or sub-method that will be examined.

> Statement #1: "The dollar-value method used in determining the taxpayer's LIFO inventories in tax years subsequent to the tax year Year 19."

This statement is almost identical to the first example contained in section 3.08(1) of Rev. Proc. 97-27. That example clearly indicates that this sort of statement lacks the specificity that is required to place an issue under consideration. Therefore, this statement, by itself or in the context of the opening statement, does not place any of Taxpayer's LIFO methods or sub-methods under consideration.

> Statement #2: "The method used by the taxpayer in costing its LIFO inventories."

This statement is vague and lacks specificity. It could refer to the taxpayer's method of determining the current-year cost of LIFO inventories under § 1.472-8(e)(2)(ii). It could also refer to the taxpayer's method of determining inventoriable costs under section 263A. The statement is no more specific as to the method that will be examined when read in the context of the opening statement or statement #1. Thus, this statement, by itself or in conjunction with the opening statement or statement #1, does not place any of Taxpayer's accounting methods or sub-methods under consideration.

> Statement #3: "The method used by the taxpayer in the pooling of its LIFO inventory items/products under the dollar-value LIFO method."

This statement specifically addresses the taxpayer's dollar-value LIFO pooling method. The first example contained in section 3.08(1) of Rev. Proc. 97-27 clearly demonstrates that a taxpayer's method of pooling under the dollar-value LIFO inventory method is an issue under consideration as a result of an examination plan that identifies LIFO pooling as a matter to be examined. Accordingly, this statement places Taxpayer's method of pooling dollar-value LIFO inventories under consideration.

> Statement #4: "The method used by the taxpayer in determining the number and composition of its inventory pools."

Although we determined above that the IDR sufficiently identified Taxpayer's pooling method, this statement when read in the context of the opening statement and statement #1 is even more specific. This statement indicates that the examining agent plans to evaluate whether Taxpayer has the requisite number of pools, and whether the items in each pool belong in that pool, another existing pool, or a new pool. Moreover, as stated above, the first example contained in section 3.08(1) of Rev. Proc. 97-27 clearly demonstrates that a taxpayer's method of pooling under the dollar-value LIFO inventory method is an issue under consideration as a result of an examination plan that identifies LIFO pooling as a matter to be examined. Accordingly, the IDR places Taxpayer's method of pooling dollar-value LIFO inventories under consideration.

> Statement #5: "The method used by the taxpayer in classifying and identifying items of inventory products."

This statement by itself might not be sufficiently specific because taxpayers not using the LIFO method may "classify and identify items of inventory products" for other purposes. However, this statement when read in the context of the opening statement and statement #1 specifically identifies Taxpayer's method of defining items under the dollar-value LIFO method as a method of accounting that will be examined. Therefore, the IDR places Taxpayer's LIFO item definition under consideration.

> Statement #6: "The method used by the taxpayer in determining "new items" entering the inventories."

We determined above that the IDR sufficiently identifies Taxpayer's method of defining items, which includes the taxpayer's method of determining whether new products or existing products must be treated as item categories. Nonetheless, this statement when read in the context of the opening statement, statement #1, and statement #5 specifically identifies Taxpayer's method of determining whether new products or modifications of existing products require the creation of new item categories. Thus, the IDR places Taxpayer's method of determining new items under the dollar-value LIFO method under consideration.

> Statement #7: "The double extension method used by the taxpayer in computing its base year and current year cost of its double extension inventories."

This statement is vague. Although the double-extension method is used only in connection with the dollar-value LIFO method, this statement could refer to the double-extension method the Taxpayer is using (e.g., double-extending every item or a sample of items in the pool), the Taxpayer's increment valuation method (e.g., earliest

acquisition, average cost, or most recent purchases), or the Taxpayer's method of reconstructing base-year costs for new items. Accordingly, this statement lacks the specificity that is required by section 6.03 and, therefore, does not place any issue under consideration.

In summary, the issues placed under consideration by the March 13, Year 14 IDR are Taxpayer's method of defining dollar-value LIFO items and its method of pooling dollar-value LIFO inventories. Therefore, during the 120-day window period beginning on May 6, Year 14, Taxpayer was not eligible to file a Form 3115 requesting permission to change its method of defining items under the dollar-value LIFO method.

CAVEAT(S)

A copy of this technical advice memorandum is to be given to the taxpayer(s). Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.