

Instructions for Form 3115

(Rev. May 1999)

Application for Change in Accounting Method

Section references are to the Internal Revenue Code unless otherwise noted.



Department of the Treasury
Internal Revenue Service

Privacy Act and Paperwork Reduction Act Notice. We ask for the information on this form to carry out the Internal Revenue laws of the United States. Section 446(e) says that you must obtain IRS approval before you change your method of accounting, except where otherwise provided. To obtain this approval, you are required to provide the information requested on this form. This information will be used to ensure that you are complying with the applicable laws, and to figure and collect the right amount of tax. Failure to provide all of the information requested may prevent processing of this form. Providing false information may subject you to penalties. Routine uses of this information include giving it to the Department of Justice for civil and criminal litigation, and to cities, states, and the District of Columbia for use in the administration of their taxes.

You are not required to provide the information requested on a form that is subject to the Paperwork Reduction Act unless the form displays a valid OMB control number. Books or records relating to a form or its instructions must be retained as long as their contents may become material in the administration of any Internal Revenue law. Generally, tax returns and return information are confidential, as required by section 6103.

The time needed to complete and file this form will vary depending on individual circumstances. The estimated average times are:

Form	Recordkeeping	Learning about the law or the form	Preparing and sending the form to the IRS
3115	20 hr., 34 min.	3 hr., 15 min.	4 hr., 56 min.
Sch. A	4 hr., 18 min.	1 hr., 41 min.	1 hr., 50 min.
Sch. B	4 hr., 47 min.	46 min.	2 hr., 4 min.
Sch. C	27 hr., 1 min.	1 hr., 40 min.	3 hr., 22 min.
Sch. D	5 hr., 1 min.	1 hr., 59 min.	2 hr., 9 min.

If you have comments concerning the accuracy of these time estimates or suggestions for making this form simpler, we would be happy to hear from you. You can write to the Tax Forms Committee, Western Area Distribution Center, Rancho Cordova, CA 95743-0001. **DO NOT** send the tax form to this office. Instead, see **When and Where To File** on page 2.

General Instructions

Purpose of Form

File Form 3115 to request a change in either an overall accounting method or the accounting treatment of any item. A request for a change in accounting method that includes several unrelated items or submethods of accounting is treated as a separate request for each unrelated item or submethod. Accordingly, file a separate Form 3115 for each unrelated item or submethod. See Rev. Proc. 97-27, 1997-1 C.B. 680, and section 9.01 of Rev. Proc. 99-1*, 1999-1 I.R.B. 6, for rules on changing an accounting method.

Note: For items marked with an asterisk (*), Rev. Proc. 99-1 is updated annually.

When filing Form 3115, applicants must determine if, since May 1999 (the current revision date of Form 3115), the IRS has published an accounting method ruling, notice, or procedure relating to the specific method being changed.

For more information, see **Pub. 538**, Accounting Periods and Methods.

Automatic Change Procedures

Note: All section references to Rev. Proc. 98-60, 1998-51 I.R.B. 16 refer to its APPENDIX.

An applicant that timely files and complies with an automatic change procedure obtains consent to change its accounting method. **No user fee is required if Form 3115 is filed under one of the following published automatic change procedures.**

• Trade or business expenses (section 162).

1. For lawyers handling cases on a contingent fee basis, from treating advances to their clients for litigation costs as deductible business expenses to treating the advances as loans. See section 1.01 of Rev. Proc. 98-60.

2. For taxpayers changing their method of accounting for year 2000 costs (costs incurred to ensure that computer systems are year 2000 compliant). See section 1.02 of Rev. Proc. 98-60.

• Depreciation or amortization (sections 167, 168, and 197).

1. For taxpayers changing from an impermissible method for depreciation, under which taxpayers claimed less depreciation than allowable, to a permissible method of depreciation, under which the taxpayers will claim the depreciation allowable. See section 2.01 of Rev. Proc. 98-60.

2. For taxpayers changing from one permissible method for depreciation under section 167 to another permissible method for depreciation under section 167. See section 2.02 of Rev. Proc. 98-60.

3. For taxpayers changing their method of accounting from treating property as sold to treating property as leased and vice versa, and taxpayers changing their method of accounting from treating property as purchased to treating property as leased and vice versa. See section 2.03 of Rev. Proc. 98-60.

• Research and Experimental Expenditures (section 174).

For taxpayers changing their treatment of expenditures that qualify as research and experimental expenditures under section 174 for a particular project or projects (a) from treating such expenditures as expenses to treating the expenditures as deferred expenses or vice versa; (b) to a different period of amortization for such expenditures that are being treated as deferred expenses; or (c) from treating such expenditures as expenses or deferred expenses to treating the expenditures as capital expenditures under section 263(a) or vice versa. See section 2A.01 of Rev. Proc. 98-60.

• Capital expenditures (section 263).

1. For taxpayers changing to one of the three alternative methods for package design

costs described in Rev. Proc. 97-35, 1997-2 C.B. 448. See section 3.01 of Rev. Proc. 98-60.

2. For taxpayers changing their method of accounting for line pack gas or cushion gas to a method consistent with the holding in Rev. Rul. 97-54, 1997-2 C.B. 23. See section 3.02 of Rev. Proc. 98-60.

• Uniform capitalization (section 263A).

For certain "small resellers," "formerly small resellers," or "reseller-producers" changing their method for costs subject to section 263A. See section 4.01 of Rev. Proc. 98-60.

• Plan contributions and deferred compensation (section 404).

For taxpayers changing their method of accounting to comply with Regulations section 404(a)(11) regarding the payment of deferred compensation. See Notice 99-16, 1999-13 I.R.B. 10.

• Methods of accounting (section 446).

1. For certain taxpayers changing to an overall accrual method or to an overall accrual method in conjunction with the recurring item exception under section 461(h)(3) in specified situations. See section 5.01 of Rev. Proc. 98-60.

2. For accrual method manufacturers, wholesalers, and retailers of motor vehicles or other durable consumer goods that sell multi-year service warranty contracts changing to the service warranty income method described in Rev. Proc. 97-38, 1997-2 C.B. 479. See section 5.02 of Rev. Proc. 98-60.

3. For manufacturers, wholesalers, and retailers of motor vehicles or other durable consumer goods that purchase multi-year service warranty insurance policies in connection with the sale of multi-year service warranty contracts to customers changing their method of accounting for premiums paid in advance to capitalize the amount paid or incurred and amortize the amount over the life of the insurance policy. See section 5.03 of Rev. Proc. 98-60.

4. For taxpayers changing their method of accounting from the Rule of 78s method to the constant yield method for stated interest on certain short term consumer loans. See section 5.04 of Rev. Proc. 98-60.

• **Obligations issued at discount (section 454).** For cash method taxpayers changing the method of accounting for interest income on series E or EE U.S. savings bonds. See section 6.01 of Rev. Proc. 98-60.

• **Prepaid subscription income (section 455).** For accrual method taxpayers changing their method of accounting for prepaid subscription income to the method described in section 455. See section 7.01 of Rev. Proc. 98-60.

• Taxable year of deduction (section 461).

1. For accrual method taxpayers changing their method of accounting to treat bonuses or self-insured medical benefits as follows: (a) if the obligation to pay a bonus becomes fixed and certain by the end of the tax year, and the bonus is otherwise deductible, but the bonus is paid more than 2 1/2 months after the end of the tax year, to treat the bonus as deductible in the tax year of the employer in which or with which ends the tax year of the employee in which the bonus is includible in the gross income of the employee, or (b) if the obligation to pay an employee's medical expenses is neither insured nor paid from a welfare benefit fund within the meaning of section 419(e), to

treat the liability as incurred in the tax year in which the employee files the claim with the employer. See section 8.01 of Rev. Proc. 98-60.

2. For accrual method taxpayers changing their method of accounting for real property taxes: (a) to treat the liability for the taxes as incurred in the tax year the taxes are paid, (b) to account for the taxes under the recurring item exception to the economic performance rules, or (c) to revoke an election under section 461(c) (ratable accrual election). See section 8.02 of Rev. Proc. 98-60.

3. For accrual method taxpayers changing their method of accounting for self-insured liabilities arising under any workers' compensation act, or out of any tort, breach of contract, or violation of law, to treat the liability as incurred in the tax year in which all events have occurred which establish the fact of liability, the amount of the liability can be determined with reasonable accuracy, and payment is made to the person to whom the liability is owed. See section 8.03 of Rev. Proc. 98-60.

4. For accrual method taxpayers changing their method for FICA and FUTA taxes to a method consistent with Rev. Rul. 96-51, 1996-2 C.B. 36. See section 8.04 of Rev. Proc. 98-60.

5. For taxpayers changing their method of accounting for cooperative advertising cost to a method consistent with the holding in Rev. Rul. 98-39, 1998-33 I.R.B. 4. See section 8.05 of Rev. Proc. 98-60.

• **Inventories (section 471).**

1. For taxpayers changing their method of accounting for cash discounts from the method of including the price of the goods before discount in the cost of goods sold and including in gross income any discounts taken, to the method of reducing the cost of goods sold by the cash discounts and deducting as an expense any discounts not taken, or vice versa. See section 9.01 of Rev. Proc. 98-60.

2. For taxpayers changing to a method of accounting for estimating inventory shrinkage in computing ending inventory using the "retail safe harbor method" in section 4 of Rev. Proc. 98-29, 1998-15 I.R.B. 22, or another method provided the taxpayer's present method does not estimate inventory shrinkage and the taxpayer's new method clearly reflects the taxpayer's taxable income. See section 9.02 of Rev. Proc. 98-60.

• **Last-in, first-out (LIFO) inventories (section 472).**

1. For taxpayers changing from the LIFO inventory method for all their inventory. See section 10.01 of Rev. Proc. 98-60.

2. For taxpayers using the LIFO inventory method changing their method of determining the cost of used vehicles purchased or taken as a trade-in, to (a) determine the cost of used vehicles acquired by trade-in using the average wholesale price listed by an official used car guide on the date of the trade-in, (b) determine the cost of used vehicles purchased for cash using the actual purchase price of the vehicle, or (c) reconstruct the beginning-of-the-year cost of used vehicles purchased for cash using values computed by national auto auction companies based on vehicles purchased for cash. See section 10.02 of Rev. Proc. 98-60.

3. For taxpayers engaged in the trade or business of retail sales of new automobiles or new light-duty trucks changing to the Alternative LIFO Method described in Rev. Proc. 97-36, 1997-2 C.B. 450. See section 10.03 of Rev. Proc. 98-60.

4. For taxpayers changing their LIFO inventory method to use the inventory price index computation (IPIIC) method for their entire LIFO inventory. See section 10.04 of Rev. Proc. 98-60.

5. For taxpayers using the LIFO inventory method changing to a method of determining current year costs: (a) by reference to the

actual cost of the goods most recently purchased or produced, (b) by reference to the actual cost of the goods purchased or produced during the tax year in the order of acquisition, or (c) by application of an average unit cost. See section 10.05 of Rev. Proc. 98-60.

• **Mark-to-market accounting method for dealers in securities.**

1. For taxpayers changing their method of accounting to comply with elections out of certain exemptions from dealers status for purposes of section 475. See Rev. Proc. 97-43, 1997-2 C.B. 494.

2. For taxpayers discontinuing the mark-to-market method of accounting for nonfinancial customer paper to comply with section 475(c)(4) for the taxpayer's first taxable year ending after July 22, 1998. The taxpayer must change to a method other than the lower of cost or market method. See section 10A.01 of Rev. Proc. 98-60.

• **Bank reserves for bad debts (section 585).** For banks as defined in section 581 (other than large banks as defined in section 585(c)(2)), including banks for which a qualified subchapter S subsidiary election (QSSS) is filed, changing their method of accounting for bad debts from the section 585 reserve method to the section 166 specific charge-off method. See section 11.01 of Rev. Proc. 98-60.

• **Original issue discount (section 1273).**

1. For taxpayers changing their method of accounting for de minimis OID (discount) to the principal-reduction method described in Rev. Proc. 97-39, 1997-2 C.B. 485. See section 12.01 of Rev. Proc. 98-60.

2. For taxpayers required to change their method of accounting for a pool of debt instruments to comply with section 1272(a)(6) for the taxpayer's first taxable year beginning after August 5, 1997. See section 12.02 of Rev. Proc. 98-60.

• **Short-term obligations (section 1281).**

1. For taxpayers changing their method of accounting for interest income on short-term obligations to comply with section 1281. See section 13.01 of Rev. Proc. 98-60.

2. For cash method banks in the Eighth Circuit to change to the cash method for stated interest on short-term loans made in the ordinary course of business. See section 13.02 of Rev. Proc. 98-60.

• **Stripped bonds (section 1286).** For certain taxpayers under examination that sell mortgages and retain rights to service the mortgages. See Rev. Proc. 91-51, 1991-2 C.B. 779.

Who Must File

Generally, individuals, partnerships, corporations, S corporations, personal service corporations, cooperatives, insurance companies, controlled foreign corporations, estates and trusts, and tax-exempt organizations must file Form 3115 to change their accounting method. The "applicant" is the taxpayer whose accounting method is being changed.

Each applicant that is part of a related group must generally file a separate Form 3115. However, Rev. Proc. 92-90, 1992-2 C.B. 501, and Appendix A of Rev. Proc. 99-1* provide that a single Form 3115 may be filed by a parent corporation requesting the identical accounting method change on behalf of more than one member of a consolidated group.

When and Where To File

A Form 3115 that is filed under Rev. Proc. 97-27 must be filed during the tax year for which the change is requested. If the tax year is a short period, file Form 3115 by the last day of the short tax year. Form 3115 should be filed as early as possible during the year of change to provide adequate time for the IRS to respond

prior to the original due date of the applicant's return for the year of change.

Applicants filing under any automatic change procedures (see list beginning on page 1) generally must complete and file an application in duplicate. The original must be attached to the taxpayer's timely filed (including extensions) original Federal income tax return for the year of the change. A copy of the application must be filed with the IRS National Office no earlier than the first day of the year of change and no later than when the original is filed with the Federal income tax return for the year of change.

Applicants, other than exempt organizations, file Form 3115 under Rev. Proc. 97-27 with the Internal Revenue Service, Associate Chief Counsel (Domestic), Attention: CC:DOM:CORP:T, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044. Exempt organizations file with the Internal Revenue Service, Assistant Commissioner (Employee Plans and Exempt Organizations), Attention: E:EO, P.O. Box 120, Ben Franklin Station, Washington, DC 20044.

The IRS normally acknowledges receipt of a completed Form 3115 within 30 days after the applicant's filing date. If nothing has been received within 30 days of filing Form 3115, the applicant can inquire to: Internal Revenue Service, Control Clerk, CC:DOM:IT&A, Room 5508, 1111 Constitution Avenue, NW, Washington, DC 20224.

Note: Applicants filing under any of the **Automatic Change Procedures** will not receive an acknowledgment.

User Fee

Applicants filing under an automatic change procedure do not pay a user fee. Other applicants requesting a change under Rev. Proc. 97-27 must pay a user fee of \$1,200 for each Form 3115. Generally, a separate user fee must be paid for each member of an affiliated group that files an application. However, for rules regarding a parent corporation requesting the identical accounting method change for more than one member of a consolidated group, see paragraph (A)(5) of Appendix A of Rev. Proc. 99-1*.

Taxpayers whose gross income (as defined in Appendix A of Rev. Proc. 99-1*) is less than \$1 million (\$150,000 if the request involves a personal tax issue) qualify for a reduced user fee of \$500. The user fee (check or money order payable to the Internal Revenue Service) **must** be attached to Form 3115.

Late Application

A taxpayer that fails to timely file a Form 3115 will not be granted an extension of time to file under Regulations section 301.9100-1 except in unusual or compelling circumstances.

Applicants filing a ruling request for an extension of time to file Form 3115 under Regulations section 301.9100-1 must pay a \$700 user fee. A taxpayer that receives an extension of time under Regulations section 301.9100-1 must also pay a separate user fee for the accounting method request. See paragraph (A)(3)(b) of Appendix A of Rev. Proc. 99-1*.

Specific Instructions

Follow the instructions below to correctly complete Form 3115.

• All applicants complete Parts I through IV unless otherwise permitted.

Eligibility to request change using Automatic Revenue Procedures. The questions in Part I that determine the eligibility of a taxpayer to request a change under Rev. Proc. 97-27 are also generally applicable to taxpayers changing their method of accounting under an automatic revenue procedure. (For

example, see section 4.02 of Rev. Proc. 98-60). However, taxpayers also must:

1. Review the eligibility requirements applicable to the revenue procedure under which they are filing, and
2. Disclose all information relevant to their eligibility to request the change regardless of whether the information is requested on Form 3115.

- All applicants complete Schedules A, B, C, and D, as appropriate, to the change in method requested.

Attachments submitted with Form 3115 must show the applicant's name and identification number. Also, indicate that the information is an attachment to Form 3115.

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Identification Number

Individuals. Individuals enter their social security number (SSN). If the application is for a husband and wife who file a joint income tax return, enter both SSNs.

Others. The employer identification number (EIN) of an applicant other than an individual should be entered here. If the EIN is unknown because one has been applied for but not yet received, enter "Applied for."

Address

Include the suite, room, or other unit number after the street address. If the Post Office does not deliver mail to the street address and the applicant has a P.O. box, show the box number instead of the street address.

Person To Contact

The person to contact must be an individual authorized to sign Form 3115, or the applicant's authorized representative. If this person is an agent for the applicant, attach **Form 2848**, Power of Attorney and Declaration of Representative.

Type of Accounting Method Change Requested

Check the appropriate box described below indicating the type of change being requested.

- **Depreciation or amortization.** Check this box for a change in either (a) the computation of depreciation or amortization (e.g., the depreciation method or recovery period), or (b) the treatment of salvage proceeds or costs of removal.
- **Financial products and/or financial activities of financial institutions.** Check this box for a change in the treatment of a financial product (e.g., accounting for debt instruments, derivatives, mark-to-market accounting, etc.), or in the financial activities of a financial institution (e.g., a lending institution, a regulated investment company, a real estate investment trust, a real estate mortgage investment conduit, a financial asset securitization investment trust, etc.).
- **Other.** Check this box if neither of the above boxes applies to the requested change. State the type of method change being requested and, in the space provided, enter a short description of the change (e.g., LIFO to FIFO, change within section 263A costs, deduction of warranty expenses, etc.).

Signature

Form 3115 **MUST** be signed and dated by the applicant as discussed below. The applicants must print or type their full name below their signature.

Individual. If the application is filed for a husband and wife who file a joint income tax return, the names of both should appear in the heading and both should sign.

Partnerships. Show the name of the partnership followed by the signature of one of the general partners and the words "General Partner."

Corporations, S corporations, personal service corporations, cooperatives, and insurance companies. Show the name of the company and the signature of the president, vice president, treasurer, assistant treasurer, or chief accounting officer (such as the tax officer) authorized to sign, and that person's official title. Receivers, trustees, or assignees must sign the application they are required to file. For a subsidiary corporation filing a consolidated return with its parent, the form must be signed by an officer of the parent corporation.

Controlled foreign corporations (CFCs). Show the name of the controlling U.S. shareholder(s) and the signature of a principal officer of each CFC.

Estates or trusts. Show the name of the estate or trust and the official title and signature of the fiduciary, personal representative, executor, administrator, etc., having legal authority to sign.

Tax-exempt organizations. Show the name of the organization and the signature of a principal officer or other person authorized to sign, followed by that person's official title.

Preparer other than applicant. If the individual preparing the application is not the applicant, the preparer also must sign.

Pages 2 and 3

Line 12. True copies of all contracts, agreements, instruments, proposed disclaimers, and other documents directly related to the proposed accounting method change must be submitted with the request.

Line 14a. Insurance companies must also state whether the proposed method of accounting will be used for annual statement accounting purposes.

Line 17. If the applicant is a member of a related group, provide the gross receipts for each member.

The "gross receipts" includes total sales (net of returns and allowances) and amounts received for services. In addition, gross receipts includes any income from investments and from incidental or outside sources (e.g., interest, dividends, rents, royalties, annuities, etc.). However, if the applicant is a reseller of personal property, exclude from gross receipts amounts not derived in the ordinary course of a trade or business.

Gross receipts do not include amounts received for sales taxes if, under the applicable state or local law, the tax is legally imposed on the purchaser of the good or service, and the applicant only collects the tax and remits it to the taxing authority.

Line 25. An individual authorized to represent the applicant before the IRS, to receive a copy of the requested ruling, or to perform any other act(s), must properly reflect the authorization on Form 2848.

Schedule A

Part I—Change in Overall Method

All applicants filing to change their overall method of accounting must complete Part I.

Section 5.01 of Rev. Proc. 98-60 provides an automatic change procedure the applicant may use to obtain expeditious approval for change from the cash method or a hybrid method to an overall accrual method or an overall accrual method in conjunction with the recurring item exception to the economic performance rules. The procedure does not apply to a taxpayer required to use inventories unless:

- The taxpayer is a reseller adopting the simplified resale method under Regulations section 1.263A-3(d), or
- The taxpayer is a small reseller within the meaning of Regulations section 1.263A-3(a), including a small reseller with de minimis production activities within the meaning of Regulations section 1.263A-3(a)(2)(iii).

The procedure also does not apply to a taxpayer required to use a long-term contract method under section 460 or a taxpayer changing to a special method of accounting unless the taxpayer is permitted to change automatically to the special method under Rev. Proc. 98-60.

Examples of special methods include the use of a long-term contract method, the nonaccrual-experience method, the method of accounting for prepaid subscription income provided in section 455, and the method of accounting for advance payments under either Rev. Proc. 71-21, 1971-2 C.B. 549, or Regulations section 1.451-5.

A taxpayer changing to an overall accrual method in conjunction with an inventory method of accounting or a special method of accounting must submit a Form 3115 under Rev. Proc. 97-27.

Lines 1a through 1g. Although some amounts requested here may not have been required in figuring taxable income due to the applicant's present method of accounting, include those amounts on lines 1a through 1g. Schedule A will be incomplete if these amounts are omitted.

Note: Do not include amounts that correct a math or posting error, errors in figuring tax liability, or an adjustment to the useful life of a depreciable asset.

Line 1b. Include amounts received or reported as income that were not earned in the prior year. For example, a discount on installment loans is reported as income in the year the loans were made instead of in the year(s) the income was received or earned.

Line 1h. The following example illustrates how an applicant figures the section 481(a) adjustment when changing to an accrual method, a nonaccrual-experience method, and the recurring item exception.

Example. ABC corporation, a calendar year taxpayer using the cash method of accounting, has the following items of unreported income and expense on December 31, 1998:

Accrued income.....	\$250,000
Uncollectible amounts based on the nonaccrual-experience method.	50,000
Accrued amounts properly deductible (economic performance has occurred)	75,000
Expenses eligible for recurring item exception	5,000

ABC corporation changes to an overall accrual method, a nonaccrual-experience method, and the recurring item exception for calendar year 1999. The section 481(a) adjustment is figured as follows:

Accrued income	\$250,000
Less:	
Uncollectible amount.....	50,000
Net income accrued but not received	\$200,000
Less:	
Accrued expenses.....	75,000
Expenses deducted as recurring item.....	5,000
Total expenses accrued but not paid	80,000
Section 481(a) adjustment	\$120,000

Line 2. If an applicant is requesting to use the recurring item exception (section 461(h)(3)), the section 481(a) adjustment must include the amount of the additional deduction that results from using the recurring item exception.

Part II—Change to the Cash Method

Limits on cash method use. Except as provided below, C corporations and partnerships with a C corporation as a partner may not use the cash method of accounting. Tax shelters, also, are precluded from using the cash method. For this purpose, a trust subject to tax on unrelated business income under section 511 is treated as a C corporation with respect to its unrelated trade or business activities.

The limit on the use of the cash method under section 448 does not apply to:

1. Farming businesses as defined in section 448(d)(1).
2. Qualified personal service corporations as defined in section 448(d)(2).
3. C corporations and partnerships with a C corporation as a partner if the corporation or partnership has gross receipts of \$5 million or less. See section 448(c) to determine if the applicant qualifies for this exception.

Farming corporations should see section 447 for limits on the use of the cash method.

Another limit on the use of the cash method exists under Regulations sections 1.471-1 and 1.446-1(c)(2)(i) if the applicant purchases, produces, or sells merchandise that is an income-producing factor in its business.

Schedule B

Use this schedule to request a change from one LIFO inventory method or submethod to another LIFO inventory method or submethod. All applicants changing within the LIFO inventory method or submethod must complete Part I. Complete Parts II and III only if applicable.

Part III—Change to Inventory Price Index Computation (IPIC) Method

Applicants changing to the IPIC method must use this method for all LIFO inventories. See **Last-in, first-out (LIFO) inventories (section 472)** under the **Automatic Change Procedures** on page 2.

Schedule C

Part I—Change in Reporting Income From Long-Term Contracts

Line 2a. Under section 460(f), the term “long-term contract” means any contract for the manufacture, building, installation, or construction of property that is not completed in the tax year in which it is entered into. However, a manufacturing contract will not qualify as long-term unless the contract involves the manufacture of (a) a unique item not normally included in finished goods inventory, or (b) any item that normally requires more than 12 calendar months to complete.

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Generally, all long-term contracts entered into after July 10, 1989, that do not meet the exceptions under section 460(e) must be accounted for using the percentage of completion method. See Notice 89-15, 1989-1 C.B. 634, and section 460.

Line 2b. To qualify for the contract exceptions under section 460(e), the contract must be:

1. A home construction contract entered into after June 20, 1988, involving single family residences and dwelling units in buildings containing four or fewer units; or

2. Any other construction contract entered into by the applicant if, at the time the contract is entered into, it is expected to be completed within 2 years and the applicant's average annual gross receipts determined under section 460(e)(2) for the 3-year period preceding the tax year the contract was entered into did not exceed \$10 million.

Line 4. Under the simplified cost-to-cost method, only certain costs are used in determining both (a) costs allocated to the contract and incurred before the close of the tax year, and (b) estimated contract costs. These costs are: (1) direct material costs; (2) direct labor costs; and (3) allowable deductions for depreciation, amortization, and cost recovery allowances on equipment and facilities directly used to construct or produce the subject matter of the long-term contract.

Part II—Change in Valuing Inventories

If the applicant is currently using a LIFO inventory method or submethod and is changing to another LIFO inventory method or submethod, Part II is not applicable. Use **Schedule B, Changes Within the LIFO Inventory Method.**

Line 3. If an applicant is subject to, but not in compliance with, section 263A, generally, the applicant must first comply with section 263A before changing an inventory valuation method. See Regulations section 1.263A-7(b)(2) for exceptions.

Line 6a. If the applicant properly elected the LIFO inventory method but is unable to furnish a copy of Form(s) 970, attach the following statement to Form 3115:

“I certify that to the best of my knowledge and belief (**name of applicant**) properly elected the LIFO inventory method by filing Form 970 with its return for the tax year(s) ended (**insert date(s)**) and otherwise complied with the provisions of section 472(d) and Regulations section 1.472-3.”

Part III—Method of Cost Allocation

Applicants requesting to change their method of accounting for any property (produced or acquired) under section 263A or any long-term contracts under section 460 must complete this schedule.

If the change is for noninventory property that is subject to section 263A, attach a detailed description of the types of property involved and an explanation detailing how that property was accounted for prior to January 1, 1987.

There are several methods available for allocating and capitalizing costs under section 263A. A change to or from any of these methods is a change in accounting method that requires IRS consent. Using the applicable regulations and notice listed below, the applicant should verify which methods are presently being used and the proposed methods that will be used before completing Schedule C, Part III.

1. Allocating Direct and Indirect Costs

- Specific identification method—Regulations section 1.263A-1(f)(2).
- Burden rate method—Regulations section 1.263A-1(f)(3)(i).
- Standard cost method—Regulations section 1.263A-1(f)(3)(ii).

- Any other reasonable allocation method—Regulations section 1.263A-1(f)(4).

2. Allocating Mixed Service Costs

- Direct reallocation method—Regulations section 1.263A-1(g)(4)(iii)(A).
- Step-allocation method—Regulations section 1.263A-1(g)(4)(iii)(B).
- Simplified service cost method:
 - Using the labor-based allocation ratio—Regulations section 1.263A-1(h)(4).
 - Using the production cost allocation ratio—Regulations section 1.263A-1(h)(5).

3. Capitalizing Additional Section 263A Costs

- Simplified production method:
 - Without historic absorption ratio election—Regulations section 1.263A-2(b)(3).
 - With historic absorption ratio election—Regulations section 1.263A-2(b)(4).
- Simplified resale method:
 - Without historic absorption ratio election—Regulations section 1.263A-3(d)(3).
 - With historic absorption ratio election—Regulations section 1.263A-3(d)(4).
 - U.S. ratio method—Notice 88-104, 1988-2 C.B. 443.

Schedule D

Part I—Change in Reporting Advance Payments

Line 1. In general, payments received for services to be performed in the future must be included in gross income in the tax year of receipt. However, Rev. Proc. 71-21 allows applicants on the accrual method, in certain circumstances, to defer for Federal income tax purposes, payments received (or amounts due and payable) in 1 tax year, if the services are to be performed by the end of the succeeding tax year. Under Rev. Proc. 71-21, amounts due and payable are treated as payments received.

Line 2. Advance payments received from a contract for the sale of goods can be deferred for Federal income tax purposes until the 2nd year following the receipt of substantial advance payments on the contract. See Regulations section 1.451-5 for requirements that must be met and for the definition of “substantial advance payments.”

Part II—Change in Depreciation or Amortization

Automatic change for section 167 property. If the change is for property depreciated under section 167, the applicant may be eligible to use Rev. Proc. 98-60. See the **Automatic Change Procedures** on page 1.

When Not To File Form 3115

Do not file Form 3115:

1. To make an election under sections 167, 168, or former section 168. Make this election on the tax return for the year in which the property is placed in service.

2. To revoke an election made under sections 167, 168, or former section 168. An election made under section 168(b)(2)(C), 168(b)(3)(D), or 168(g)(7) is irrevocable. To revoke any other election under section 167 or 168, file a request for a letter ruling with the IRS at the address listed under **When and Where To File** on page 2. See Rev. Proc. 99-1*.

3. To make or revoke an election under section 13261(g)(2) or (3) of the Revenue Reconciliation Act of 1993 (relating to section 197 intangibles). Make this election in the manner prescribed in Temporary Regulations section 1.197-1T. To revoke an election, file a request for a letter ruling with the IRS at the address under **When and Where To File**. See Rev. Proc. 99-1*.