5.06 of this revenue procedure, the corporation must supply the gross receipts from sales and services for the most recent 47 months for itself (or any predecessor) in compliance with the instructions to Form 1128.

(7) *Consolidated application*. A common parent must file a single application to change the annual accounting period of its consolidated group, which consists of the parent and any subsidiary that is a member of the group on the last day of the short period.

SECTION 8. REVIEW OF APPLICATION

.01 *Service Center Review*. A Service Center may deny a change of annual accounting period under this revenue procedure only if: (a) the Form 1128 is not filed timely, or (b) the corporation fails to meet the scope or any term and condition of this revenue procedure. If the change is denied, the Service Center will return the Form 1128 with an explanation for the denial.

.02 *Review of Director*. The appropriate director may ascertain if the change in annual accounting period was made in compliance with all the applicable provisions of this revenue procedure. Corporations changing their annual accounting period pursuant to this revenue procedure without complying with all the provisions (including the terms and conditions) of this revenue procedure ordinarily will be deemed to have initiated the change in annual accounting period without the approval of the Commissioner. Upon examination, a corporation that has initiated an unauthorized change of annual accounting period may be denied the change. For example, the corporation may be required to recompute its taxable income or loss in accordance with its former (or required, if applicable) taxable year.

SECTION 9. EFFECTIVE DATE

This revenue procedure generally is effective for all changes in annual accounting periods for which the first effective year ends on or after October 18, 2006. However, if the time period for filing Form 1128 or Form 5471 with respect to a taxable year set forth in section 7.02(2) of this revenue procedure has not yet expired, a corporation within the scope of this revenue procedure may elect early application of the revenue procedure by providing the notification set forth in section 7.02(3) on the top of page 1 of Form 1128 or Form 5471 and by satisfying the other procedural requirements of section 7.

SECTION 10. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 2002–37 is clarified, modified, amplified, and superseded.

SECTION 11. PAPERWORK REDUCTION ACT

The collection of information contained in this revenue procedure has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545–1786. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid OMB control number.

The collection of information in this revenue procedure is found in section 7. The information in section 7 is required in order to determine whether the corporation properly obtained automatic approval to change its annual accounting period. The likely respondents are corporations. The estimated total annual reporting burden for the requirements contained in section 7 of this revenue procedure is reflected in the burden estimates for Forms 1128 and 5471.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

DRAFTING INFORMATION

The principal authors of this revenue procedure are Roy A. Hirschhorn and Jeffrey Marshall of the Office of Associate Chief Counsel (Income Tax and Accounting). For further information regarding this revenue procedure, contact Mr. Marshall at (202) 622–4960 (not a toll-free call).

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26 CFR 601.204: Changes in accounting periods and in methods of accounting.
(Also Part I, §§ 441, 442, 444, 706, 1378; 1.441–1, 1.441–3, 1.442–1, 1.706–1, 1.1378–1.)

Rev. Proc. 2006–46

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SECTION 1. PURPOSE

This revenue procedure provides the exclusive procedures for a partnership (as defined in section 5.02 of this revenue procedure), S corporation, electing S corporation (as defined in section 5.03 of this revenue procedure), personal service corporation (PSC) (as defined in section 5.04 of this revenue procedure), or trust within its scope — to obtain automatic approval to adopt, change, or retain its annual accounting period under § 442 of the Internal Revenue Code and § 1.442–1(b) of the Income Tax Regulations. This revenue procedure clarifies, modifies, amplifies, and supersedes Rev. Proc. 2002–38, 2002–1 C.B. 1037. A partnership, S corporation, electing S corporation, PSC, or trust complying with the applicable provisions of this revenue procedure will be deemed to have established a business purpose and obtained the approval of the Commissioner of Internal Revenue to adopt, change, or retain its annual accounting period under § 442 and the regulations thereunder.

SECTION 2. BACKGROUND

.01 *Taxable Year Defined.*

(1) *In general.* Section 441(b) and § 1.441–1(b)(1) provide that the term "taxable year" generally means the taxpayer's annual accounting period, if it is a calendar year or fiscal year, or, if applicable, the taxpayer's required taxable year.

(2) *Annual accounting period.* Section 441(c) and § 1.441–1(b)(3) provide that the term "annual accounting period" means the annual period (calendar year or fiscal year) on the basis of which the taxpayer regularly computes its income in keeping its books.

(3) *Required taxable year.*

(a) *In general.* Section 1.441–1(b)(2) provides that certain taxpayers must use the particular taxable year that is required under the Code or regulations thereunder. Exceptions to the required taxable year are provided for certain taxpayers, including a partnership, S corporation, or PSC, that make an election under § 444, elect to use a 52–53-week taxable year that ends with reference to its required taxable year or a taxable year elected under § 444, or establish a business purpose for having a different taxable year and obtain approval under § 442.

(b) *Partnerships*. Section 706(b) and § 1.706–1(b)(2) generally provide that a partnership's taxable year must be its required taxable year. However, a partnership may have a taxable year other than its required taxable year if it makes an election under § 444, elects to use a 52–53-week taxable year that ends with reference to its required taxable year or a taxable year elected under § 444, or establishes a business purpose for having a different taxable year and obtains the approval of the Commissioner under § 442. The required taxable year for a partnership is:

(i) the taxable year of one or more of its partners who have an aggregate interest in partnership profits and capital of greater than 50 percent;

(ii) if there is no taxable year described in clause (i), the taxable year of all the principal partners of the partnership (*i.e.*, all the partners having an interest of 5 percent or more in partnership profits or capital); or

(iii) if there is no taxable year described in clause (i) or (ii), the taxable year that results in the least aggregate deferral of income to the partners.

(c) *S corporations*. Section 1378 and § 1.1378–1(a) provide that the taxable year of an S corporation must be a permitted year. The term "permitted year" means (1) the required taxable year (*i.e.*, a taxable year ending on December 31), (2) a taxable year elected under § 444, (3) a 52–53-week taxable year ending with reference to the required taxable year or a taxable year elected under § 444, or (4) any other accounting period for which the corporation establishes to the satisfaction of the Commissioner a business purpose.

(d) *PSCs*. Section 441(i)(1) and § 1.441–3 provide that the taxable year of a PSC must be the calendar year unless the PSC makes an election under § 444, elects to use a 52–53-week taxable year that ends with reference to the calendar year or a taxable year elected under § 444, or establishes, to the satisfaction of the Commissioner, a business purpose for having a different period for its taxable year.

(e) *Trusts*. Section 644(a) provides that the taxable year of any trust generally must be the calendar year.

.02 *Adoption of a Taxable Year*. A newly-formed partnership, S corporation, or PSC may adopt its required taxable year, a taxable year elected under § 444, or a 52–53-week taxable year ending with reference to its required taxable year or a taxable year elected under § 444 without the approval of the Commissioner pursuant to § 441. If, however, a partnership, S corporation, or PSC wants to adopt any other taxable year, it must establish a business purpose and obtain approval under § 442. See § 1.441–1(c).

.03 *Change in Taxable Year.*

(1) *In general*. Section 1.442–1(a) generally provides that a taxpayer that wants to change its annual accounting period and use a new taxable year must obtain the approval of the Commissioner.

(2) *Annualization of short period return*. Section 443(b) and § 1.443–1(b)(1)(i) generally provide that if a return is made for a short period resulting from a change of an annual accounting period, the taxable income for the short period must be placed on an annual basis by multiplying the income by 12 and dividing the result by the number of months in the short period. Unless § 443(b)(2) and § 1.443–1(b)(2) apply, the tax for the short period generally is the same part of the tax computed on an annual basis as the number of months in the short period is of 12 months. But see §§ 1.706–1(b)(8)(i)(B) and 1.1378–1(c)(2) for exceptions to this general rule for partnerships and S corporations, respectively.

(3) *No retroactive change in annual accounting period*. Unless specifically authorized by the Commissioner, a taxpayer may not request, or otherwise make, a retroactive change in annual accounting period, regardless of whether the change is to a required taxable year.

.04 *Retention of a Taxable Year.* In certain cases, a partnership, S corporation, electing S corporation, or PSC will be required to change its taxable year unless it establishes a business purpose and obtains the approval of the Commissioner under § 442, or makes an election under § 444, to retain its current taxable year. *See* § 1.441–1(d). For example, a corporation on a June 30 fiscal year that either becomes a PSC or elects to be an S corporation, and as a result is required to use the calendar year, must obtain the approval of the Commissioner to retain its current fiscal year. Similarly, a partnership using a taxable year that corresponds to its required taxable year generally must obtain the approval of the Commissioner to retain that taxable year if its required taxable year changes as a result of a change in ownership. *But see* § 706(b)(4)(B). However, a partnership that previously has established a business purpose to the satisfaction of the Commissioner to use a particular fiscal year is not required to obtain the approval of the Commissioner to retain such fiscal year if its required taxable year changes provided such fiscal year currently qualifies as a permitted taxable year.

.05 *Approval of an Adoption, Change, or Retention.* Section 1.442–1(b) provides, in part, that in order to secure the approval of the Commissioner to adopt, change, or retain an annual accounting period, a taxpayer must file an application, generally on Form 1128, "*Application To Adopt, Change, or Retain a Tax Year*," with the Commissioner within such time and in such manner as is provided in administrative procedures published by the Commissioner. In general, an adoption, change, or retention in annual accounting period will be approved if the taxpayer establishes a business purpose for the requested annual accounting period and agrees to the Commissioner's prescribed terms, conditions, and adjustments for effecting the adoption, change, or retention.

.06 *Business Purpose.*

(1) *Sufficient business purposes*. Section 1.442–1(b)(2) provides that the requirement of a business purpose generally will be satisfied, and adjustments to neutralize any tax consequences will not be required, if the requested annual accounting period coincides with the taxpayer's required taxable year, ownership taxable year, or natural business year. Section 1.442–1(b)(2) also provides that, in the case of a partnership, S corporation, electing S corporation, or PSC, deferral of income to partners, shareholders, or employee-owners will not be treated as a business purpose.

(2) *Natural business year*. A taxpayer is deemed to have established a natural business year if it satisfies the "25-percent gross receipts test" described in section 5.07 of this revenue procedure.

.07 *Section 444 Elections.* A partnership, S corporation, electing S corporation, or PSC generally can elect under § 444 to use a taxable year other than its required taxable year, but only if the deferral period of the taxable year elected is not longer than the shorter of 3 months or the deferral period of the taxable year being changed. A partnership and an S corporation with a § 444 election must make required payments under § 7519 that approximate the amount of deferral benefit and a PSC with a § 444 election is subject to the minimum distribution requirements of § 280H. A taxpayer may automatically adopt, change to, or retain a taxable year permitted under § 444 by filing a Form 8716, "*Election To Have a Tax Year Other Than a Required Tax Year*." A taxpayer that wants to terminate its § 444 election must follow the automatic procedures under § 1.444–1T(a)(5) to change to its required taxable year or establish a business purpose for using a different taxable year pursuant to § 442, the regulations thereunder, Rev. Proc. 2002–39, 2002–1 C.B. 1046 (or any successor), or this revenue procedure (whichever is applicable).

SECTION 3. SIGNIFICANT CHANGES

Significant changes to Rev. Proc. 2002–38 made by this revenue procedure include:

.01 Section 4.01 of this revenue procedure removes from the scope a partnership that has a minor, temporary percentage change in ownership.

.02 Section 4.01(1) of this revenue procedure adds to the scope a trust that wants to change to its required taxable year.

.03 Section 4.01(5) of this revenue procedure clarifies that a taxpayer that is required to make a concurrent change as a term and condition for the approval of a related taxpayer's change of accounting period is included in the scope notwithstanding any limitation in this revenue procedure to the contrary.

.04 Section 4.02(6) of this revenue procedure excludes from the scope a terminated S corporation.

.05 Section 4.02(7) of this revenue procedure excludes from the scope a partnership, S corporation, electing S corporation, or PSC that makes or terminates a § 444 election. A taxpayer that makes or terminates a § 444 election must follow the procedures in § 444 and the regulations thereunder.

.06 Section 5.05 of this revenue procedure adds a trust to the definition of a required taxable year.

.07 Section 5.08 of this revenue procedure clarifies that, for taxable years beginning after December 31, 2002, a shareholder that is tax-exempt under § 501(a) generally is disregarded for purposes of determining the ownership taxable year of an S or electing S corporation.

.08 Section 5.10 of this revenue procedure modifies the definition of first effective year to include a short period of 6 days or less.

.09 Section 6.02(1) of this revenue procedure provides that only certain short periods are exempt from the financial statement conformity requirement and incorporates the clarification in Notice 2002–72, 2002–2 C.B. 843, of the recordkeeping/book conformity term and condition with regard to certain taxpayers changing to their required taxable year.

.10 Section 6.08 of this revenue procedure incorporates the modified carryback term and condition of section 4.01 of Rev. Proc. 2003–34, 2003–1 C.B. 856.

.11 Section 9.02 of this revenue procedure clarifies that, for a taxpayer that must change to a required year, failure to comply with all the applicable provisions of this revenue procedure does not relieve the taxpayer from any applicable penalties or interest if the taxpayer fails to make the change.

SECTION 4. SCOPE

.01 *Applicability.* Except as provided in section 4.02, this revenue procedure, which is the exclusive procedure for a taxpayer (as defined in section 5.01 of this revenue procedure) within its scope to secure the Commissioner's approval, applies to:

(1) *Required taxable year*. A partnership, S corporation, electing S corporation, PSC, or trust that wants to change to its required taxable year (as defined in section 5.05 of this revenue procedure), or a partnership, S corporation, electing S corporation, or PSC that wants to change to a 52–53-week taxable year ending with reference to such required taxable year;

(2) *Natural business year*. A partnership, S corporation, electing S corporation, or PSC (other than a member of a tiered structure as defined in § 444 and § 1.444–2T) that wants to change to or retain a natural business year that satisfies the 25-percent gross receipts test described in section 5.07 of this revenue procedure, or to a 52–53-week taxable year ending with reference to such taxable year;

(3) *Ownership taxable year*. An S corporation or electing S corporation that wants to adopt, change to, or retain its ownership taxable year (as defined in section 5.08 of this revenue procedure), or to a 52–53-week taxable year ending with reference to such taxable year;

(4) *Certain 52–53-week taxable years*. A partnership, S corporation, electing S corporation, or PSC that wants to change from a 52–53-week taxable year that references a particular calendar month to a non-52–53-week taxable year that ends on the last day of the same calendar month that is a permitted taxable year, and vice versa;

(5) *Certain taxpayers that are required to make concurrent changes*. Notwithstanding any limitation in this revenue procedure to the contrary (including any limitations in section 4.02 of this revenue procedure) or any conflicting testing date provisions, this revenue procedure applies to a taxpayer that is required to concurrently change its annual accounting period as a term and condition for the approval of a related taxpayer's change of annual accounting period.

.02 *Inapplicability.* Except as provided in section 4.01(5) of this revenue procedure, this revenue procedure does not apply to:

(1) *Under examination*. A change or retention in annual accounting period if the taxpayer is under examination (as defined in section 5.13 of this revenue procedure), unless it obtains consent of the appropriate director as provided in section 7.03(1) of this revenue procedure;

(2) *Before an area office*. A change or retention in annual accounting period if the taxpayer is before an area office with respect to any income tax issue and its annual accounting period is an issue under consideration (as defined in section 5.14 of this revenue procedure) by the area office;

(3) *Before a federal court*. A change or retention in annual accounting period if the taxpayer is before a federal court with respect to any income tax issue and its annual accounting period is an issue under consideration by the federal court;

(4) *Issue under consideration in connection with partner or shareholder return*. A change or retention in annual accounting period by a partnership or S corporation if, on the date the taxpayer otherwise would file its application with the Service Center, the taxpayer's annual accounting period is an issue under consideration in the examination of a partner's or shareholder's federal income tax return or an issue under consideration by an area office or by a federal court with respect to a partner's or shareholder's federal income tax return; or

(5) *Prior change*. A change to, or retention of, a natural business year as described in section 4.01(2) of this revenue procedure if the taxpayer has changed its annual accounting period at any time within the most recent 48-month period ending with the last month of the requested taxable year. For this purpose, the following changes are not considered prior changes in annual accounting period:

(a) a change to a required taxable year or ownership taxable year;

(b) a change from a 52–53-week taxable year to a non-52–53-week taxable year that ends with reference to the same calendar month, and vice versa; or

(c) a change in accounting period by an S corporation, electing S corporation, or PSC, in order to comply with the common taxable year requirements of §§ 1.1502–75(d)(3)(v) and 1.1502–76(a)(1).

(6) *Terminated S corporation*. A corporation that is requesting a change in a taxable year that is within an S termination year (as defined in § 1362(e)(4)).

(7) *Section 444 election*. A partnership, S corporation, electing S corporation, or PSC that makes or terminates a § 444 election.

.03 *Nonautomatic Changes.* Any taxpayer that wants to adopt, change to, or retain an annual accounting period that cannot do so automatically under this revenue procedure (because the requested taxable year is not described in section 4.01 or because of any application of section 4.02) or pursuant to a provision in the Code, regulations, or other published administrative procedures, must obtain the approval of the Commissioner. *See* § 1.442–1(b) and Rev. Proc. 2002–39 (or any successor) for rules relating to nonautomatic changes of annual accounting periods by partnerships, S corporations, electing S corporations, PSCs, and trusts.

SECTION 5. DEFINITIONS

The following definitions apply solely for purposes of this revenue procedure:

.01 *Taxpayer.* The term "taxpayer" has the same meaning as the term "person" as defined in § 7701(a)(1) (*e.g.*, an individual, trust, estate, partnership, association, or corporation) rather than the meaning of the term "taxpayer" as defined in § 7701(a)(14) (any person subject to tax).

.02 *Partnership.* A partnership is any entity classified as a partnership for purposes of § 7701(a)(3) or the regulations thereunder.

.03 *Electing S Corporation.* An "electing S corporation" is a corporation attempting to make an S corporation election for the short period (as defined in section 5.11 of this revenue procedure). See Rev. Proc. 2006–45, 2006–45 I.R.B. 851, for procedures for automatic approval to change an annual accounting period by corporations attempting to make an S corporation election for the taxable year immediately following the first effective year (as defined in section 5.10 of this revenue procedure).

.04 *PSC.* A PSC is a personal service corporation as defined in § 441(i)(2). For purposes of this revenue procedure, a PSC does not include a corporation that has a required taxable year under a provision of the Code other than § 441(i) (*e.g.*, a specified foreign corporation as defined in § 898(b)(1)).

.05 *Required Taxable Year.* The "required taxable year" is the taxable year determined under § 706(b) in the case of a partnership, § 644 in the case of a trust, § 1378 in the case of an S corporation or an electing S corporation, or § 441(i) in the case of a PSC, without taking into account any taxable year that is allowable by reason of a business purpose (including a grandfathered fiscal year as defined in section 5.09 of this revenue procedure) or a § 444 election.

.06 *Permitted Taxable Year.* A "permitted taxable year" is the required taxable year; a natural business year; the ownership taxable year; a taxable year elected under § 444; a 52–53-week taxable year that references the required taxable year, natural business year, ownership taxable year, or a taxable year elected under § 444; or any other taxable year for which the taxpayer establishes a business purpose to the satisfaction of the Commissioner.

.07 *Natural Business Year.* A "natural business year" is a year for which a partnership, S corporation, electing S corporation, or PSC satisfies the following "25-percent gross receipts test":

(1) *25-percent gross receipts test*. Except as provided in (2) below, the 25-percent gross receipts test is satisfied if each of the results described in (a) and (b) below equals or exceeds 25-percent:

(a) Gross receipts from sales and services for the most recent 12-month period that ends with the last month of the requested annual accounting period are totaled and then divided into the amount of gross receipts from sales and services for the last 2 months of this 12-month period.

(b) The same computation as in (1)(a) above is made for the two preceding 12-month periods ending with the last month of the requested annual accounting period.

(2) *Exception*. The taxpayer must determine whether any annual accounting period other than the requested annual accounting period also meets the 25-percent test described in (1). If one or more other annual accounting periods produce higher averages of the three percentages (rounded to 1/100 of a percent) described in (1) than the requested annual accounting period, then the requested annual accounting period will not qualify as the taxpayer's natural business year.

(3) *Special rules*.

(a) To apply the 25-percent gross receipts tests for any particular taxable year, the taxpayer must compute its gross receipts from sales and services under the method of accounting used to prepare its federal income tax returns for such taxable year.

(b) If a taxpayer has a predecessor organization and is continuing the same business as its predecessor, the taxpayer must use the gross receipts from sales and services of its predecessor for purposes of computing the 25-percent gross receipts test.

(c) If the taxpayer (including any predecessor organization) does not have a 47-month period of gross receipts (36-month period for requested taxable year plus additional 11-month period for comparing requested taxable year with other potential taxable years), then it cannot establish a natural business year under this revenue procedure.

(d) If the requested taxable year is a 52–53-week taxable year, the calendar month ending nearest to the last day of the 52–53-week taxable year is treated as the last month of the requested taxable year for purposes of computing the 25-percent gross receipts test.

.08 *Ownership Taxable Year.* For an S corporation or electing S corporation, an "ownership taxable year" is the taxable year (if any) that, as of the first day of the first effective year, constitutes the taxable year of one or more shareholders (including any shareholder that concurrently changes to such taxable year) holding more than 50-percent of the corporation's issued and outstanding shares of stock. Under principles similar to § 1.706–1(b)(5) for determining the taxable year of a partnership, a shareholder that is tax-exempt under § 501(a) is disregarded if such shareholder is not subject to tax on any income attributable to the S corporation. Tax-exempt shareholders are not disregarded, however, if the S corporation is wholly-owned by such tax-exempt entities. A shareholder in an S corporation or electing S corporation that wants to concurrently change its taxable year must follow the instructions generally applicable to taxpayers changing their taxable years contained in § 1.442–1(b), Rev. Proc. 2002–39 (or any successor), or any other applicable administrative procedure published by the Commissioner.

.09 *Grandfathered Fiscal Year.* A "grandfathered fiscal year" is a fiscal year (other than a year that resulted in a three-month or less deferral of income) that a partnership or an S corporation received permission to use on or after July 1, 1974, by a letter ruling (*i.e.*, not by automatic approval).

.10 *First Effective Year.* The "first effective year" is the first taxable year for which an adoption, change, or retention in annual accounting period is effective. The first effective year generally is the short period required to effect the change. In the case of a short period of 6 days or less, the first effective year is the taxable year that includes such short period under § 1.441–2(b)(2)(ii). The first effective year is also the first taxable year for complying with all the terms and conditions set forth in this revenue procedure necessary to effect the adoption, change, or retention in annual accounting period.

.11 *Short Period.* In the case of a change in annual accounting period, a taxpayer's "short period" is the period beginning with the day following the close of the old taxable year and ending with the day preceding the first day of the new taxable year.

.12 *Field Office, Area Office, Director.* The terms "field office," "area office," and "director" have the same meaning as those terms have in Rev. Proc. 2006–1, 2006–1 I.R.B. 1 (or any successor).

.13 *Under Examination.*

(1) *In general.*

(a) Except as provided in section 5.13(2) of this revenue procedure, an examination of a taxpayer with respect to a federal income tax return begins on the date the taxpayer is contacted in any manner by a representative of the Service for the purpose of scheduling any type of examination of the return. An examination ends:

(i) in a case in which the Service accepts the return as filed, on the date of the "no change" letter sent to the taxpayer;

(ii) in a fully agreed case, on the earliest of the date the taxpayer executes a waiver of restrictions on assessment or acceptance of overassessment (for example, Form 870, 4549, or 4605), the date the taxpayer makes a payment of tax that equals or exceeds the proposed deficiency, or the date of the "closing" letter (for example, Letter 891(IN) or 987(DO)) sent to the taxpayer; or

(iii) in an unagreed or a partially agreed case, on the earliest of the date the taxpayer (or its representative) is notified by an area officer that the case has been referred to an area office from a field office, the date the taxpayer files a petition in the Tax Court, the date on which the period for filing a petition with the Tax Court expires, or the date of the notice of claim disallowance.

(b) An examination does not end as a result of the early referral of an issue to an area office under the provisions of Rev. Proc. 99–28, 1999–2 C.B. 109.

(c) An examination resumes on the date the taxpayer (or its representative) is notified by an appeals officer (or otherwise) that the case has been referred to a field office for reconsideration.

(2) *Partnerships and S corporations subject to TEFRA*. For a partnership or S corporation that is subject to the TEFRA unified audit and litigation provisions (note that an S corporation is not subject to the TEFRA unified audit and litigation provisions for taxable years beginning after December 31, 1996; see Small Business Job Protection Act of 1996, Pub. L. No. 104–188, § 1317(a), 110 Stat. 1755, 1787 (1996)), an examination begins on the date that the notice of the beginning of an administrative proceeding is sent or personally delivered to the Tax Matters Partner/Tax Matters Person (TMP). An examination ends:

(a) in a case in which the Service accepts the partnership or S corporation return as filed, on the date of the "no adjustments" letter or the "no change" notice of final administrative adjustment sent to the TMP;

(b) in a case in which no formal notice is given, the period of limitations on assessment has expired for all partners with respect to the partnership items of the partnership;

(c) in a fully agreed case, when all the partners or shareholders execute a Form 870–P, 870–L, 870–S, or any variation thereof; or

(d) in an unagreed or a partially agreed case, on the earliest of the date the TMP (or its representative) is notified by an appeals officer that the case has been referred to an area office from a field office, the date the TMP (or a partner, member, or shareholder) requests judicial review, or the date on which the period for requesting judicial review expires.

.14 *Issue Under Consideration.*

(1) *During an examination*. A taxpayer's annual accounting period 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 adjustments or income tax examination changes) from the examining agent(s) specifically citing the taxpayer's annual accounting period as an issue under consideration. For example, a taxpayer's annual accounting period is an issue under consideration as a result of an examination plan that identifies the propriety of the taxpayer's annual accounting period as a matter to be examined. The question of whether the taxpayer's annual accounting period is an issue under consideration may be referred to the national office as a request for technical advice under the provisions of Rev. Proc. 2006–2, 2006–1 I.R.B. 89 (or any successor).

(2) *Before an area office*. A taxpayer's annual accounting period is an issue under consideration for the taxable years before an area office if the taxpayer's annual accounting period is included as an item of adjustment in the examination report referred to the area office or is specifically identified in writing to the taxpayer by the area office.

(3) *Before a federal court*. A taxpayer's annual accounting period is an issue under consideration for the taxable years before a federal court if the taxpayer's annual accounting period is an item included in the statutory notice of deficiency, the notice of claim disallowance, the notice of final administrative adjustment, the pleadings (for example, the petition, complaint, or answer) or amendments thereto, or is specifically identified in writing to the taxpayer by the government counsel.

SECTION 6. TERMS AND CONDITIONS OF CHANGE

.01 *In General.* An adoption, change, or retention in annual accounting period filed under this revenue procedure must be made pursuant to the terms and conditions provided in this revenue procedure.

.02 *Record Keeping/Book Conformity.*

(1) *In general*. The taxpayer must compute its income and keep its books and records (including financial statements and reports to creditors) on the basis of the requested taxable year. The books and records of the taxpayer must be closed as of the last day of the first effective year and the taxpayer must conform the accounting period used for financial statement purposes and reports to creditors concurrently.

(2) *Certain short periods exempt from financial statement conformity*. If the taxpayer is not required to issue financial statements for the short period required to effect the change, the taxpayer will be deemed to have met the financial statement conformity requirement for the first effective year provided the taxpayer's accounting period used for financial statement purposes already conforms to the requested taxable year or the taxpayer makes the change in accounting period used for financial statement purposes and reports to creditors concurrently.

(3) *Certain taxpayers using required year exempt from financial statement conformity*. If the requested taxable year is the taxpayer's required taxable year, the taxpayer must compute its income and keep its books and records for U.S. federal income tax purposes on the basis of the required taxable year, but is not required to conform its financial statements and reports to creditors on the basis of the required taxable year. The books and records of the taxpayer must be closed as of the last day of the first effective year.

.03 *First Effective Year Tax Return.*

(1) *When to file*. The taxpayer generally must file a federal income tax return for the first effective year by the due date of that return, including extensions, in accordance with § 1.443–1(a).

(2) *Annualization*. If the taxpayer is a PSC or a trust, the taxpayer's taxable income for the short period must be annualized and the tax must be computed in accordance with the provisions of § 443(b) and § 1.443–1(b). However, for changes to (or from) a 52–53-week taxable year referencing the same month as the current (or requested) taxable year, see special rules in § 1.441–2.

.04 *Subsequent Year Tax Returns.* Returns for subsequent taxable years generally must be made on the basis of a full 12 months (or on a 52–53-week basis) ending on the last day of the requested taxable year, unless the taxpayer secures the approval of the Commissioner to change that taxable year.

.05 *Changes in Natural Business Year.* If a partnership, S corporation, electing S corporation, or PSC changes to or retains a natural business year and that year no longer qualifies as a permitted taxable year, the taxpayer is using an impermissible annual accounting period and must change to a permitted taxable year. Taxpayers qualifying under section 4 of this revenue procedure may request automatic approval for the change under the provisions of this revenue procedure. Other taxpayers must request approval under Rev. Proc. 2002–39 (or any successor).

.06 *Changes in Ownership Taxable Year.* An S corporation or electing S corporation that adopts, changes to, or retains an ownership taxable year under this revenue procedure must change to a permitted taxable year, or request approval to retain its current taxable year, if, as of the first day of any taxable year, its ownership taxable year changes. S corporations qualifying under section 4 of this revenue procedure may request automatic approval for the change or retention under the provisions of this revenue procedure. Other taxpayers must request approval under Rev. Proc. 2002–39 (or any successor).

.07 *52–53-week Taxable Years.* If applicable, the taxpayer must comply with § 1.441–2(e) (relating to the timing of taking items into account in those cases where the taxable year of a pass-through entity or PSC ends with reference to the same calendar month as one or more of its partners, shareholders, or employee-owners).

.08 *Creation of Net Operating Loss or Capital Loss.* In the case of a PSC changing its annual accounting period, if the PSC generates a net operating loss (NOL) or capital loss (CL) in the short period required to effect the change in annual accounting period, the PSC may not carry the NOL or CL back, but must carry it over in accordance with the provisions of §§ 172 and 1212, respectively, beginning with the first taxable year after the short period. However, except as provided in § 280H and the regulations thereunder, the short period NOL or CL must be carried back or carried over in accordance with § 172 or 1212, respectively, if it is either (a) $50,000 or less; or (b) less than the NOL or CL, respectively, generated for the full 12-month period beginning with the first day of the short period. The taxpayer must wait until this 12-month period has expired to determine whether the taxpayer qualifies for the exception in (b) above.

.09 *Creation of General Business Credits.* In the case of a PSC changing its annual accounting period, if there is an unused general business credit or any other unused credit generated in the short period, the PSC must carry that unused credit forward. An unused credit from the short period may not be carried back.

SECTION 7. GENERAL APPLICATION PROCEDURES

.01 *Approval.* Approval is hereby granted to any taxpayer within the scope of this revenue procedure to adopt, change, or retain its annual accounting period, provided the taxpayer complies with all the applicable provisions of this revenue procedure. Approval is granted beginning with the first effective year. A taxpayer granted approval under this revenue procedure to adopt, change to, or retain an annual accounting period other than its required year is deemed to have established a business purpose for the adoption, change, or retention to the satisfaction of the Commissioner.

.02 *Filing Requirements.*

(1) *Where to file*. A taxpayer within the scope of this revenue procedure that wants to adopt, change, or retain its annual accounting period under this revenue procedure must complete and file an application (*i.e.*, a current Form 1128 or, in the case of an electing S corporation, a current Form 2553, *Election by a Small Business Corporation*) with the Director, Internal Revenue Service Center, Attention: ENTITY CONTROL, where the taxpayer files its federal income tax return. No copies of Form 1128 (or Form 2553) should be sent to the national office. The taxpayer also must attach a copy of the Form 1128 (or Form 2553) to the federal income tax return filed for the first effective year.

(2) *When to file*. The Form 1128 must be filed no earlier than the day following the end of the first effective year and no later than the due date (including extensions) for filing the federal income tax return for the first effective year. For electing S corporations, the Form 2553 must be filed when the election to be an S corporation is filed pursuant to § 1362(b) and § 1.1362–6. Generally, such election must be filed at any time during (a) the taxable year that immediately precedes the taxable year for which the election is to be effective, or (b) the taxable year for which the election is to be effective, provided the election is made before the 16th day of the third month of the taxable year.

(3) *Label*. In order to assist in the processing of the adoption, change, or retention in annual accounting period, taxpayers should write at the top of page 1 of the Form 1128 (or Form 2553): "FILED UNDER REV. PROC. 2006–46."

(4) *Signature requirements*. In the case of a partnership, the Form 1128 must be signed on behalf of the partnership by a general partner. In the case of a limited liability company that elects to be treated as a partnership, the Form 1128 must be signed by a member-manager who has personal knowledge of the facts set forth on the form. In all other cases, the Form 1128 (or Form 2553) must be signed by an authorized corporate officer. If an agent is authorized to represent the taxpayer before the Service, to receive the original or a copy of correspondence concerning the application, or to perform any other act(s) regarding the application on behalf of the taxpayer, a Form 2848, *Power of Attorney and Declaration of Representative*, reflecting such authorization(s) should be attached to the application. A taxpayer's representative without a power of attorney to represent the taxpayer will not be given any information about the application.

(5) *No user fee*. A user fee is not required for applications filed under this revenue procedure and, except as provided in section 9.01 of this revenue procedure, the receipt of an application filed under this revenue procedure may not be acknowledged.

(6) *Additional information*. In the case of a taxpayer changing to a natural business year that satisfies the 25-percent gross receipts test described in section 5.07 of this revenue procedure, the taxpayer must supply the gross receipts from sales and services for the most recent 47 months for itself (or any predecessor) in compliance with the instructions to Form 1128 (or Form 2553).

.03 *Additional Procedures If Under Examination, Before an Area Office, or Before a Federal Court.*

(1) *Taxpayer under examination*.

(a) A taxpayer under examination may request approval to change or retain its annual accounting period under this revenue procedure only if the appropriate director consents to the change or retention. The director will consent to the change or retention unless, in the opinion of the director, the taxpayer's annual accounting period ordinarily would be included as an item of adjustment in the year(s) for which the taxpayer is under examination. For example, the director will consent to a change if the taxpayer is using a permissible annual accounting period. The director also will consent to a change from an impermissible annual accounting period if the period became impermissible (*e.g.*, due to a change in ownership or a change in the taxpayer's business) subsequent to the years under examination. The question of whether the taxpayer's annual accounting period from which the taxpayer is changing is permissible or became impermissible subsequent to the years under examination may be referred to the national office as a request for technical advice under the provisions of 2006–2, 2006–1 I.R.B. 89 (or any successor).

(b) A taxpayer changing or retaining an annual accounting period under this revenue procedure with the consent of the appropriate director must attach to the application a statement from the director consenting to the change or retention. The taxpayer must provide a copy of the application to the director at the same time it files the application with the Service Center. The application must contain the name(s) and telephone number(s) of the examining agent(s).

(2) *Taxpayer before an area office*. A taxpayer that is before an area office must attach to the application a separate statement signed by the taxpayer certifying that, to the best of the taxpayer's knowledge, the taxpayer's annual accounting period is not an issue under consideration by the area office. The taxpayer must provide a copy of the application to the appeals officer at the same time it files the application with the Service Center. The application must contain the name and telephone number of the appeals officer.

(3) *Taxpayer before a federal court*. A taxpayer that is before a federal court must attach to the application a separate statement signed by the taxpayer certifying that, to the best of the taxpayer's knowledge, the taxpayer's annual accounting period is not an issue under consideration by the federal court. The taxpayer must provide a copy of the application to the government counsel at the same time it files the application with the Service Center. The application must contain the name and telephone number of the government counsel.

SECTION 8. EFFECT OF APPROVAL

.01 *Audit Protection.*

(1) *In general*. Except as provided in section 8.01(2) of this revenue procedure, a taxpayer that files an application in compliance with all the applicable provisions of this revenue procedure will not be required by the Service to change its annual accounting period for a taxable year prior to the first effective year.

(2) *Exceptions*. The Service may change a taxpayer's annual accounting period for a prior taxable year if:

(a) the taxpayer fails to implement the change;

(b) the taxpayer implements the change but does not comply with all the applicable provisions of this revenue procedure; or

(c) there was a misstatement or omission of material facts.

.02 *Subsequently Required Changes.*

(1) *In general*. A taxpayer that adopts, changes, or retains its annual accounting period pursuant to this revenue procedure may be required to subsequently change its annual accounting period for the following reasons:

(a) the enactment of legislation;

(b) a decision of the United States Supreme Court;

(c) the issuance of temporary or final regulations;

(d) the issuance of a revenue ruling, revenue procedure, notice, or other statement published in the Internal Revenue Bulletin;

(e) the issuance of written notice to the taxpayer that the change in annual accounting period was not in compliance with all the applicable provisions of this revenue procedure or is not in accord with the current view of the Service; or

(f) a change in the material facts on which the approval was granted.

(2) *Retroactive change*. Except in rare circumstances, if a taxpayer that adopts, changes, or retains its annual accounting period under this revenue procedure is subsequently required under section 8.02(1) of this revenue procedure to change that annual accounting period, the required change will not be applied retroactively, provided that:

(a) the taxpayer complied with the applicable provisions of this revenue procedure;

(b) there has been no misstatement or omission of material facts;

(c) there has been no change in the material facts on which the approval was based;

(d) there has been no change in the applicable law; and

(e) the taxpayer to which the approval was granted acted in good faith in relying on the approval, and applying the change retroactively would be to the taxpayer's detriment.

SECTION 9. REVIEW OF APPLICATION

.01 *Service Center Review.* A Service Center may deny an adoption, change, or retention of an annual accounting period under this revenue procedure only if: (1) the Form 1128 (or Form 2553) is not filed timely, or (2) the taxpayer fails to meet the scope or any term and condition of this revenue procedure. If the application is denied, the Service Center will return the application with an explanation for the denial. In the case of a denial of an accounting period request filed on Form 2553, the taxpayer will be required to use the calendar year or, if applicable, make a § 444 election, if it chooses to be an S corporation.

.02 *Review of Director.* The appropriate director may ascertain if the adoption, change, or retention of annual accounting period was made in compliance with all the applicable provisions of this revenue procedure. Taxpayers adopting, changing, or retaining their annual accounting period pursuant to this revenue procedure without complying with all the provisions (including the terms and conditions) of this revenue procedure ordinarily will be deemed to have initiated the adoption, change, or retention of annual accounting period without the approval of the Commissioner. Upon examination, a taxpayer that has initiated an unauthorized adoption, change, or retention of annual accounting period may be denied the adoption, change, or retention. For example, the taxpayer may be required to recompute its taxable income or loss in accordance with its former (or required, if applicable) taxable year. For a taxpayer that must change to a required year, failure to comply with all the applicable provisions of this revenue procedure does not relieve the taxpayer from the requirement to change to the required year and, if the taxpayer does not change to the required year, does not prevent the imposition of any applicable penalty or addition of any amount to tax.

SECTION 10. EFFECTIVE DATE

This revenue procedure generally is effective for adoptions, changes, or retentions of annual accounting periods for which the first effective year ends on or after October 18, 2006. However, if the time period for filing Form 1128 (or Form 2553) with respect to a taxable year set forth in section 7.02(2) of this revenue procedure has not yet expired, a taxpayer within the scope of this revenue procedure may elect early application of the revenue procedure by providing the notification set forth in section 7.02(3) on the top of page 1 of Form 1128 (or Form 2553) and by satisfying the other procedural requirements of section 7.

SECTION 11. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 2002–38 is clarified, modified, amplified, and superseded.

SECTION 12. PAPERWORK REDUCTION ACT

The collection of information contained in this revenue procedure has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545–1786. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid OMB control number.

The collection of information in this revenue procedure is found in section 7. The information in section 7 is required in order to determine whether the taxpayer properly obtained automatic approval to adopt, change, or retain its annual accounting period. The likely respondents are the following: partnerships, S corporations, electing S corporations, PSCs, and trusts. The estimated total annual burden for the requirements contained in section 7 of this revenue procedure is reflected in the burden estimates for Forms 1128 and 2553.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

DRAFTING INFORMATION

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26 CFR 1.199–2: Wage Limitation.
(Also: 26 CFR 1.199–2T.)

Methods of Determining Paragraph (e)(1) Wages for Purposes of the § 199(b)(1) Wage Limitation on the § 199 Deduction

Rev. Proc. 2006–47

SECTION 1. PURPOSE

This revenue procedure provides methods used as part of calculating W–2 wages for purposes of § 199(b)(1) of the Internal Revenue Code, which limits the amount of the § 199 deduction for income attributable to domestic production activities to 50 percent of the W–2 wages of the taxpayer for the taxable year.

Section 514(a) of the Tax Increase Prevention and Reconciliation Act of 2005 (Public Law 109–222) (TIPRA) imposes a new limitation on W–2 wages for purposes of § 199 for taxable years beginning after May 17, 2006. Under the change made by TIPRA, W–2 wages, for purposes of § 199, include *only* amounts that are properly allocable to domestic production gross receipts (DPGR) for purposes of § 199(c)(1). Thus, to determine such W–2 wages for taxable years beginning after May 17, 2006, it is necessary to determine the amount that would have been W–2 wages for purposes of § 199 before the amendment by TIPRA and then to determine the portion of that amount properly allocable to DPGR.

This revenue procedure provides methods for calculating the amount of wages described in § 1.199–2(e)(1) of the Income Tax Regulations ("paragraph (e)(1) wages"). Section 1.199–2T(e)(2) of the temporary Income Tax Regulations provides that the term W–2 wages includes only paragraph (e)(1) wages that are properly allocable to DPGR for purposes of § 199(c)(1). Thus, for taxable years covered by this revenue procedure, a taxpayer first determines the amount of paragraph (e)(1) wages under this revenue procedure and then applies § 1.199–2T(e)(2) to determine the amount of W–2 wages.

Section 1.199–2(e)(3) of the regulations provides the Internal Revenue Service with authority to issue guidance providing the methods that may be used to calculate W–2 wages. Section 1.199–2(e)(3) is effective for taxable years beginning on or after June 1, 2006. In Rev. Proc. 2006–22, 2006–23 I.R.B. 1033, the Internal Revenue Service provided methods for calculating W–2 wages for taxpayers who choose to apply the final regulations to taxable years beginning before June 1, 2006, but only for taxable years beginning on or after January 1, 2005, and on or before May 17, 2006. For taxable years covered by this revenue procedure, this revenue procedure provides methods to determine paragraph (e)(1) wages, but taxpayers must then subject such wages to the limitation contained in § 1.199–2T(e)(2) of the temporary regulations to determine W–2 wages.

SECTION 2. BACKGROUND

Section 199(a) provides a deduction for an amount equal to a percentage of the lesser of (A) the qualified production activities income of the taxpayer for the taxable year, or (B) taxable income (determined without regard to § 199) for the taxable year (or, in the case of an individual, adjusted gross income).

Section 199(b)(1) provides that the amount of the deduction allowable under § 199(a) for any taxable year shall not exceed 50 percent of the W–2 wages of the taxpayer for the taxable year. For this purpose, § 199(b)(2)(A) defines the term "W–2 wages" to mean, with respect to any person for any taxable year of such person, the sum of the amounts described in § 6051(a)(3) and (8) paid by such person with respect to employment of employees by such person during the calendar year ending during such taxable year. Section 199(b)(2)(C) provides that W–2 wages shall not include any amount that is not properly included in a return filed with the Social Security Administration (SSA) on or before the 60th day after the due date (including extensions) for such return.

Section 514(a) of TIPRA added § 199(b)(2)(B) to exclude from the term W–2 wages any amount that is not properly allocable to domestic production gross receipts for purposes of § 199(c)(1). Section 199(b)(2)(B) is effective with respect to taxable years beginning after the date of enactment, May 17, 2006. Temporary and final regulations have been issued to reflect the changes in the definition of W–2 wages made by TIPRA. Section 1.199–2T(e)(2) of the temporary regulations provides rules for applying the TIPRA limitation on W–2 wages under § 199(b)(2)(B).

This revenue procedure provides three methods for calculating paragraph (e)(1) wages. These methods for calculating paragraph (e)(1) wages are generally similar to the methods used to calculate W–2 wages before the amendment made by TIPRA as set forth in Rev. Proc. 2006–22, § 1.199–2 of the proposed regulations that were published in the **Federal Register** on November 4, 2005 (REG–105847–05, 2005–47 I.R.B. 987 [70 FR 67220]), and section 4.02 of Notice 2005–14, 2005–1 C.B. 498, 514. The first method (the unmodified Box method) allows for a sim-