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August 7, 2007

Part IV

Department of the Treasury

Internal Revenue Service

26 CFR Parts 1, 301 and 602
Corporate Estimated Tax; Final Rule

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Parts 1, 301, and 602

[TD 9347]

RIN 1545–AY22

Corporate Estimated Tax

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations that provide guidance to corporations with respect to estimated tax requirements. These final regulations generally affect corporate taxpayers who are required to make estimated tax payments. These final regulations reflect changes to the law since 1984. This document also removes the section 6154 regulations.

DATES: *Effective date:* These regulations are effective on August 7, 2007.

Applicability date: These regulations apply to tax years beginning after September 6, 2007.

FOR FURTHER INFORMATION CONTACT: Timothy Sheppard, at (202) 622–4910 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

This document contains amendments to the Income Tax Regulations (26 CFR part 1), the Procedure and Administration Regulations (26 CFR part 301), and the OMB Control Numbers under the Paperwork Reduction Act Regulations (26 CFR part 602) relating to corporate estimated taxes under section 6425 and section 6655 of the Internal Revenue Code (Code). This document also removes §§ 1.6154–1, 1.6154–2, 1.6154–3, 1.6154–4, 1.6154–5, and 301.6154–1. The IRS is removing the section 6154 regulations because Congress repealed section 6154 in 1987.

These regulations reflect changes to the law made by the Deficit Reduction Act of 1984, Public Law 98–369 (98 Stat. 494); the Superfund Amendments and Reauthorization Act of 1986, Public Law 99–499 (100 Stat. 1613); the Tax Reform Act of 1986, Public Law 99–514 (100 Stat. 2085); the Omnibus Budget Reconciliation Act of 1987, Public Law 100–203 (101 Stat. 1330); the Revenue Act of 1987, Public Law 100–203 (101 Stat. 1330–382); the Omnibus Trade and Competitiveness Act of 1988, Public Law 100–418 (102 Stat. 1107); the Technical and Miscellaneous Revenue Act of 1988, Public Law 100–647 (102 Stat. 3342); the Omnibus Budget Reconciliation Act of 1989, Public Law 101–239 (103 Stat. 2106); the Omnibus Budget Reconciliation Act of 1990, Public Law 101–508 (104 Stat. 1388); the Tax Extension Act of 1991, Public Law 102–227 (105 Stat. 1686); the Act of Feb. 7, 1992, Public Law 102–244 (106 Stat. 3); the Unemployment Compensation Amendments of 1992, Public Law 102–318 (106 Stat. 290); the Omnibus Budget Reconciliation Act of 1993, Public Law 103–66 (107 Stat. 312); the Uruguay Round Agreements Act of 1994, Public Law 103–465 (108 Stat. 4809); the Small Business Job Protection Act of 1996, Public Law 104–188 (110 Stat. 1755); the Taxpayer Relief Act of 1997, Public Law 105–34 (111 Stat. 788); the Ticket to Work and Work Incentives Improvement Act of 1999, Public Law 106–170 (113 Stat. 1860); the Community Renewal Tax Relief Act of 2000, Public Law 106–554 (114 Stat. 2763); the Economic Growth and Tax Relief Reconciliation Act of 2001, Public Law 107–16 (115 Stat. 38); the Jobs and Growth Tax Relief Reconciliation Act of 2003, Public Law 108–27 (117 Stat. 752); and the American Jobs Creation Act of 2004, Public Law 108–357 (118 Stat. 1418).

These regulations do not reflect changes made by the Tax Increase Prevention and Reconciliation Act of 2005, Public Law 109–222 (120 Stat. 345) (TIPRA), as amended by the U.S. Troop Readiness, Veterans' Care, Katrina Recovery, and Iraq Accountability Act of 2007, Public Law 110–28 (121 Stat. 112), because TIPRA made temporary, targeted changes to the time and amount of any required installment otherwise due in September 2010 and September 2011. TIPRA also changed the amount of required installments in 2006, 2012, and 2013 for corporations with assets of not less than $1 billion. Although these changes are not reflected in these regulations, these and any further changes made in the Code supersede the rules in these regulations.

A notice of proposed rulemaking under section 6655 (REG–107722–00) was published in the **Federal Register** (70 FR 73393) on December 12, 2005. The proposed regulations provide guidance on how to determine the amount of a corporation's estimated tax due with each quarterly installment. No requests for a public hearing were received, so the public hearing on the proposed regulations, scheduled for March 15, 2006, was cancelled. The IRS received written and electronic comments responding to the notice of proposed rulemaking. After consideration of all comments, the proposed regulations are adopted as revised by this Treasury decision.

Explanation of Provisions and Summary of Comments

Section 6655 generally requires corporations to make quarterly estimated tax payments or be assessed an addition to tax for any underpayment. As a general rule, payments are due on the fifteenth day of the fourth, sixth, ninth, and twelfth months. Each quarterly payment must be at least twenty-five percent of the required annual payment in order to avoid an underpayment penalty. Generally, the required annual payment equals one hundred percent of the tax shown on the return for the current year tax, or for certain small taxpayers, the lesser of one hundred percent of the tax shown on the return for the current year tax or one hundred percent of the tax shown on the return for the preceding taxable year. Alternatively, corporations may elect to use an annualized income installment or an adjusted seasonal installment if less than the amount computed under the general rules.

1. Comments Concerning § 1.6655–1 (Addition to Tax in the Case of a Corporation) of the Proposed Regulations

A. Recapture of a Tax Credit Not Included in the Definition of ''Tax''

One commentator requested that the final regulations clarify that the recapture of a tax credit under Chapter 1 is not a section 11 tax and not included within the definition of tax for purposes of section 6655 unless there is authority that provides that the recaptured credit is treated as a tax imposed by section 11.

Revenue Ruling 78–257 (1978–1 CB 440) provides that the term *tax*, as defined in section 6655, includes the amount of tax resulting from the recomputation of a prior year's investment credit at the applicable rate for the current year. However, *Berkshire Hathaway, Inc.* v. *United States*, 802 F.2d 429 (Fed. Cir. 1986), held that, for purposes of the definition of tax under section 6655, the recapture tax under former section 47 was not a tax imposed by section 11. The Court concluded that because the taxpayer paid no tax imposed by section 11 in the preceding taxable year, that taxpayer was not subject to an addition to tax for failing to pay estimated tax in the current year under the former provision in section 6655(d)(2) that allowed a taxpayer to pay estimated tax in the current year based on the law applicable to (other than the rates), and the known facts of, the prior year's return. Based on the holding in *Berkshire Hathaway*, § 1.6655–1(g)(1)(iii) of the final regulations provides that, unless otherwise provided in the Internal Revenue Code, for purposes of the definition of tax as used in section 6655, a recapture of tax, such as a recapture provided by section 50(a)(1)(A) and any other similar provision, is not considered to be a tax imposed by section 11. Therefore, Rev. Rul. 78–257 is removed. See § 601.601(d)(2)(ii)(*b*).

B. Tax Rate Changes for Preceding Year Safe Harbor

Section 6655(d)(1)(B)(ii) allows taxpayers to determine their required annual payment based on 100 percent of the tax shown on the preceding year's return. Commentators suggested that the rule provided in § 1.6655–1(g)(3) of the proposed regulations, which requires taxpayers to recompute the tax determined for the preceding taxable year based on the current year tax rates if the tax rates for the current year and the preceding year differ, is not authorized by section 6655. The commentators suggested that, prior to the effective date of its amendment in 1987, section 6655 allowed estimated tax payments to be based on the facts shown on the return for the preceding taxable year and the law applicable to that year but using the tax rates for the current taxable year. The commentators requested that the final regulations not adopt the rule provided in § 1.6655–1(g)(3) of the proposed regulations.

Section 6655 no longer provides specific statutory authority to recompute tax determined for the preceding taxable year using the rates applicable to the current taxable year. Therefore, the final regulations do not adopt the rule provided in § 1.6655–1(g)(3) of the proposed regulations.

C. Return for the Preceding Taxable Year

One commentator requested that the final regulations clarify that the regulations adopt the holding in *Mendes* v. *Commissioner*, 121 T.C. 308 (2003). In *Mendes*, the Tax Court held that a tax return that is filed after the IRS issues a notice of deficiency is not a return for purposes of section 6654(d)(1)(B)(i). Id. at 324–325. *Mendes* cited *Evans Cooperage Co., Inc.* v. *United States*, 712 F.2d 199 (5th Cir. 1983), for the proposition that the purpose of the preceding year safe harbor is "to provide a predictable escape from any possible penalty liability [and this purpose] would be defeated if penalties for underpayment of estimated taxes during the year were based, not on the easily determinable amount reflected on the preceding year's return, but instead upon the ultimate tax liability, possibly determined by adverse tax audit, a year or so after the tax year for * * * which the estimated tax installments were paid." *Mendes*, 121 T.C. at 326 (quoting *Evans Cooperage*, 712 F.2d at 204). *Evans Cooperage* held that the statutory reference to "tax shown on the return of the corporation for the preceding taxable year" refers to the timely filed return for the preceding year, not to any later-filed amended return. *Evans Cooperage*, 712 F.2d at 204.

Section 1.6655–1(g)(2) of the proposed regulations provides that the reference in section 6655(d)(1)(B)(ii) to "return of the corporation of the preceding taxable year" includes the Federal income tax return as amended, only if an amended Federal income tax return has been filed before the due date for an installment. As long as a taxpayer has remaining estimated tax installment payments to make during the tax year and is basing the payments on the preceding year return, the remaining payments should be made based on the most recent information the IRS has on the preceding year return. This includes the information on an amended return for the preceding year filed before an installment due date. Section 1.6655–1(g)(2) of the final regulations retains this rule but clarifies that the term "return for the preceding taxable year" includes the Federal income tax return as amended only if filed before the applicable installment due date if an amended Federal income tax return is filed for the preceding taxable year. If an amended Federal income tax return is filed on or after an installment due date, then the term "return for the preceding taxable year" does not include that amended Federal income tax return with respect to the installments due prior to the time the amended Federal income tax return is filed. This rule applies regardless of whether the IRS issues a notice of deficiency prior to the filing of the amended Federal income tax return.

2. Comments Concerning § 1.6655–2 (Annualized Income Installment Method) of the Proposed Regulations

As a general comment to the proposed regulations, one commentator noted that the estimated tax payment rules should strive to provide the most accurate picture of annualized taxable income based on facts known as of the end of an annualization period. The IRS and Treasury Department agree with this comment and recognize that treating an annualization period as a short taxable year does not necessarily result in an accurate estimate of annualized taxable income. The final regulations make it clear that taxpayers may not determine taxable income for an annualization period or an adjusted seasonal installment period as though the period is a short taxable year.

Consistent with the general rejection of a short taxable year approach, the final regulations recognize that certain types of items that are generally incurred once (or otherwise infrequently) during the taxable year or that are subject to special exceptions, should not be annualized because doing so would create a distortion in the estimate of annualized taxable income. This approach also recognizes that although distortions may occur in the annualization process due to general fluctuations in the timing of items of income and deductions incurred throughout the year, taxpayers should generally be permitted to rely on such annualized estimates to the extent the estimate is based upon information available to the taxpayer as of the end of the annualization period.

A commentator expressed concern that the rules provided in the proposed regulations were too mechanical and created traps for the unwary. In response to this comment, the final regulations provide rules which are intended to produce a reasonably accurate estimate of annualized taxable income for estimated tax purposes without imposing an undue compliance burden on taxpayers. Specifically, the final regulations address this general concern by allowing taxpayers to make a reasonably accurate allocation of certain items of income or expense. However, a taxpayer's annualized taxable income for estimated tax purposes is primarily based on items of income and expense recognized during the annualization period. Therefore, the annualization method is as inherently complex as computing taxable income.

A. Reasonably Accurate Allocation

Commentators noted that many of the rules provided in the proposed regulations with respect to economic performance and recurring expenses would create significant administrative burdens, result in similarly situated taxpayers being treated differently, and did not further the underlying goal of providing an accurate picture of annualized taxable income.

The final regulations do not retain the recurring expense rules provided in the proposed regulations. The final regulations provide special rules for specific items of deduction that are routinely incurred on an annual basis or for which a special exception to the general accounting rules exists. Given the nature of these items, applying the general annualization rules to these items could result in a significant distortion in the estimate of annualized taxable income. These items include real property tax deductions; employee and independent contractor bonus compensation deductions (including the employer's share of employment taxes related to such compensation); deductions under sections 404 (deferred compensation) and 419 (welfare benefit funds); items allowed as a deduction for the taxable year by reason of section 170(a)(2) and § 1.170A–11(b) (certain charitable contributions by accrual method corporations), § 1.461–5 (recurring item exception) or § 1.263(a)–4(f) (12-month rule); and items of deduction designated by the Secretary by publication in the Internal Revenue Bulletin (IRB) (see § 601.601(d)(2)(ii)(b)).

The final regulations require that these specified items of deduction be allocated in a reasonably accurate manner. The item of deduction that must be allocated in a reasonably accurate manner includes the total amount of the item of deduction recognized by the taxpayer during the taxable year regardless of whether the item is deemed to be paid or incurred during the taxable year as a result of events that occurred during the taxable year, after the taxable year, or both. While a reasonably accurate allocation may permit certain items to be recognized in an annualization period prior to being paid or incurred, an amount may only be taken into account to the extent the item of deduction is properly recognized by the taxpayer during the taxable year. Therefore, taxpayers will be subject to a section 6655 addition to tax for an underpayment of estimated tax if an underpayment results from a deduction the taxpayer expected to be incurred but was not ultimately recognized as a deduction by the taxpayer in the computation of taxable income for that year.

The final regulations provide that an allocation will be considered to be made in a reasonably accurate manner if the item is allocated ratably throughout the tax year. In addition, an allocation will be considered to be made in a reasonably accurate manner to the extent it provides a reasonable estimate of taxable income for the taxable year based upon the facts known as of the end of the annualization period. The final regulations provide a list of some relevant factors to be taken into consideration in determining whether an allocation provides a reasonable estimate of taxable income based upon facts known as of the end of the annualization period. The IRS and Treasury Department recognize that various allocations may be considered to be done in a reasonably accurate manner and intend for taxpayers to have flexibility in determining which allocation to use, particularly when use of a specific allocation reduces administrative burdens on the taxpayer. In general, allocations that are made with the intent to distort will not be considered to have been made in a reasonably accurate manner.

Many of the items of deduction which are required to be allocated in a reasonably accurate manner include items that may not have otherwise been allowed to be taken into account by taxpayers (for example, year-end bonus liabilities, items paid after year end) under the general annualization rules to the extent they were deemed to be incurred in the last quarter of the year. In this regard, the final regulations provide a measure of relief to taxpayers with respect to such items. The final regulations provide that the Secretary may designate in future IRB guidance additional items of deduction that are required to be allocated in a reasonably accurate manner. Taxpayers are encouraged to bring items to the attention of the IRS and Treasury Department that they believe should be allocated in a reasonably accurate manner rather than applying the general annualization rules.

Commentators requested that taxpayers be permitted to take the exceptions provided in section 170(a)(2) and § 1.170A–11(b) (certain charitable contributions by accrual method corporations), § 1.461–5 (recurring item exception) or § 1.263(a)–4(f) (12-month rule) into account for purposes of determining items of expense incurred during an annualization period. As noted above, these exceptions frequently apply either to expenses paid annually or to expenses paid after the end of the taxable year. The specific rules and underlying intent of these exceptions do not easily translate to the concept of an annualization period. The final regulations provide that items of expense that utilize these exceptions will be considered to be properly taken into account if they are allocated among annualization periods in a reasonably accurate manner. Therefore, the final regulations permit taxpayers for estimated tax payment purposes to allocate throughout the tax year items of deduction recognized in the taxable year as a result of these exceptions to the extent the allocation is made in a reasonably accurate manner. The final regulations adopt this approach in order to reduce the complexity and burden associated with the computation of estimate taxes by allowing taxpayers to allocate these specific items of expense in a reasonably accurate manner while also preventing unintended distortions under the annualization method.

B. Net Operating Loss Deductions

Several commentators addressed provisions in the proposed regulations requiring a net operating loss (NOL) deduction to be taken into account in computing an annualized installment after annualizing the taxable income for the annualization period. One commentator argued that economic performance with respect to an NOL carryover has already occurred and therefore, the NOL deduction should be taken into account in computing an annualized installment before annualizing the taxable income for the annualization period. Another commentator suggested that special rules be provided for extraordinary items such as NOL deductions noting the unique nature of such items. Comments were also received suggesting that NOL deductions should be treated the same as any other deduction.

NOL deductions are different from other items of deduction occurring throughout the year in that there is no anticipation that similar deductions will recur throughout the year or in future years. In this regard, NOL deductions are more like extraordinary items. Treating NOL deductions in the same manner as other recurring deductions would be inconsistent with attempting to provide a reasonably accurate picture of annualized taxable income and could result in a distorted estimate of annualized taxable income similar to the distortions created by the various techniques the regulations are intended to prevent. The final regulations treat a NOL deduction as an extraordinary item that is treated as occurring on the first day of the taxable year and is taken into account after annualization. As a result of the final regulations, Rev. Rul. 67–93 (1967–1 CB 366) is removed. See § 601.601(d)(2)(ii)(*b*).

C. Credit Carryovers

One commentator suggested that a credit carryover should be taken into account in computing an annualized installment before annualizing the taxable income for the annualization period because economic performance has occurred for the credit carryover. In general, taxpayers annualize components of a credit for the current taxable year to determine the amount of a credit because the credit is based on components for the current year. However, credit carryovers are generally based on the components for the entire year in which the credit arose. Therefore, the credit carryover already is computed based on annualized components for the year in which the credit arose. Because a credit carryover is based on annualized components, the final regulations provide that a credit carryover must be taken into account after determining the annualized tax and before taking into account the applicable percentage for the annualization period.

D. Credits Incurred in an Annualization Period and Recaptured Credits

One commentator suggested that the final regulations provide that credits incurred in an annualization period are not annualized. The commentator suggested that annualization should be based on the underlying basis for the credit. The commentator also suggested that if a credit is based on an item that is annualized in computing the required installment for the annualization period, the amounts should be annualized in determining the amount of the credit. Finally, the commentator suggested that similar rules should apply to the recapture of credits that are included within the definition of tax.

Section 1.6655–2(f)(3)(iii) of the final regulations provides that the items upon which the credit is computed are annualized pursuant to the provisions of § 1.6655–2(f)(1) and the amount of the credit is computed based on the annualized items. The amount of the credit is then deducted from the annualized tax. For example, for an annualization period consisting of three months in a full 12-month taxable year, the items upon which the credit is based that are taken into account for the three-month period are multiplied by four, the credit is determined, and the credit reduces the annualized tax. Reducing the annualized tax by a credit before taking into account the applicable percentage is consistent with the statutory definition of tax provided in section 6655(g)(1) and the annualized income installment method provided in section 6655(e). In order to clarify this rule, § 1.6655–2(b)(1) of the final regulations provides that tax means tax after taking into account credits and before applying the applicable percentage. These rules generally do not apply to a credit recapture because, as discussed in heading 1A of the preamble, a credit recapture, such as a recapture provided by section 50(a)(1)(A), is not taken into account when determining the tax for an annualized income installment for purposes of section 6655.

E. Depreciation and Amortization Expense

One commentator requested clarification on the alternative method in § 1.6655–2(f)(2)(v)(A) of the proposed regulations. The proposed regulations provide that a taxpayer may claim for an annualization period at least a proportionate amount of 50 percent of the taxpayer's estimated depreciation and amortization (depreciation) expense for the current taxable year attributable to assets that a taxpayer had in service on the last day of the preceding taxable year, that remain in service on the first day of the current taxable year, and that are subject to the half-year convention. Several commentators suggested that the regulations were not clear on how a taxpayer determines how much more than 50 percent may be used and requested that the final regulations provide criteria for making this determination.

Another commentator suggested that the general rule in § 1.6655–2(f)(2)(v)(A) of the proposed regulations for taking into account depreciation was impractical for many taxpayers because of the administrative burdens associated with the computation of actual and expected depreciation expense. The commentator also suggested that the rule does not provide an alternative calculation methodology for assets subject to a convention other than the half-year convention or for intangible assets. The commentator requested that the final regulations provide alternative computation methodologies for all depreciable and amortizable assets and allow taxpayers to take into account section 179 deductions. The commentator also requested that the final regulations eliminate the alternative rule in § 1.6655–2(f)(2)(v)(A) of the proposed regulations that allows taxpayers to take into account a proportionate amount of 50 percent of taxpayers' current year estimated depreciation expense. The commentator requested that instead the final regulations provide a safe harbor that allows taxpayers to claim a proportionate amount of 90 percent of the prior year depreciation expense for all assets placed in service in an earlier year.

By including the alternative rule in § 1.6655–2(f)(2)(v)(A) of the proposed regulations, the IRS and Treasury Department intended to illustrate the minimum amount of depreciation a taxpayer is entitled to take for a taxable year. In response to the comments referenced above, the final regulations do not include the alternative method in § 1.6655–2(f)(2)(v)(A) of the proposed regulations. The final regulations provide a general rule that permits taxpayers to estimate their annual depreciation expense and include a proportionate amount of such expense for annualization purposes. The final regulations also provide that, in determining the estimated annual depreciation expense, a taxpayer may take into account purchases, sales or other dispositions, changes in use, additional first-year depreciation deductions, and other similar events and provisions that, based on all the relevant information available as of the last day of the annualization period (such as capital spending budgets, financial statement data and projections, or similar reports that provide evidence of the taxpayer's capital spending plans for the current taxable year), are reasonably expected to occur or apply during the taxable year. The IRS and Treasury Department believe that prescribing special rules for depreciation is appropriate because unlike many other deductions, depreciation generally accrues ratably throughout the taxable year. Therefore, in contrast to the general annualization rules, the final regulations require depreciation expense to be taken into account ratably throughout the taxable year.

As an alternative to the general rule for depreciation expense, the final regulations provide two safe harbors. The first safe harbor requires taxpayers to take into account for an annualization period a proportionate amount of depreciation expense allowed for the taxable year from: (1) Assets that were in service on the last day of the prior taxable year, are in service on the first day of the current taxable year, and have not been disposed of during the annualization period; (2) assets that were placed in service during the annualization period and have not been disposed of during that period; and (3) assets that were in service on the last day of the prior taxable year and that are disposed of during the annualization period. For purposes of additional first-year depreciation deductions, the final regulations provide that only a proportionate amount of the current year's additional first-year depreciation deduction to be taken into account in determining a taxpayer's taxable income for the taxable year is taken into account in computing taxable income for an annualization period. In addition, the final regulations provide that amounts that the taxpayer deducts under section 179 or any similar provision, are treated the same as additional first-year depreciation.

The second safe harbor included in the final regulations provides that a taxpayer may take into account a proportionate amount of 90 percent of its preceding year's depreciation that is taken on its Federal income tax return for the preceding taxable year. However, if the taxpayer's preceding taxable year is less than 12 months (a short taxable year), the amount of depreciation expense taken into account for the preceding taxable year must be put on an annualized basis. In addition, a taxpayer must use whatever depreciation safe harbor method it selects under § 1.6655–2(f)(3)(iv)(B) of the final regulations for all depreciation deductions within the annualization period for the annualized income installment but may use a different depreciation method provided in § 1.6655–2(f)(3)(iv) for each annualized income installment during the taxable year.

F. Events Arising After the Installment Due Date

One commentator requested that the final regulations include examples of events that would arise after the installment due date that would be considered reasonably unforeseeable to illustrate the rule provided in § 1.6655–2(h) of the proposed regulations. In considering the request for more specific guidance as to what constitutes an unforeseeable event, the IRS and Treasury Department determined that providing relief for certain unforeseeable events would more appropriately be addressed through contemporaneous guidance. Furthermore, the unforeseeable event exception provided in the proposed regulations was inherently subjective and retaining such a rule would be difficult to administer. In addition, certain provisions in the final regulations allow events that occur after the end of an annualization period to be taken into account but only to the extent the anticipated events actually occur. Therefore, the final regulations do not retain the unforeseeable event exception as provided in § 1.6655–2(h) of the proposed regulations.

The final regulations do permit taxpayers in specific circumstances to take into account transactions that are properly reflected in the taxpayer's return for a particular year to be taken into account for annualization purposes regardless of when the underlying event giving rise to the item occurs. For example, the final regulations permit taxpayers to defer income related to a transaction to which sections 1031 or 1033 may apply even if the replacement of property required under sections 1031 or 1033 has not occurred as of the end of an annualization period to the extent the taxpayer has a reasonable belief that qualifying replacement property will be acquired.

G. Items That Substantially Affect Taxable Income But Cannot Be Determined Accurately by the Installment Due Date

Section 1.6655–2(g) of the proposed regulations provides that in determining the applicability of the annualized income installment method or the adjusted seasonal installment method, reasonable estimates may be made from existing data for items that substantially affect income if the amount of such items cannot be determined with reasonable accuracy by the installment due date. Examples of these items are the inflation index for taxpayers using the dollar-value LIFO (last-in, first-out) inventory method, intercompany adjustments for taxpayers that file consolidated returns, and the liquidation of a LIFO layer at the installment date that the taxpayer reasonably believes will be replaced at the end of the year.

The IRS and Treasury Department believe that the language in § 1.6655–2(g) of the proposed regulations could be misinterpreted and broadly applied to items to which the rule was not intended. The final regulations provide that § 1.6655–2(g) applies only to the items specifically listed. These items include the inflation index for taxpayers using the dollar-value LIFO inventory method, adjustments required under section 263A, intercompany adjustments for taxpayers that file consolidated returns, the liquidation of a LIFO layer at the installment date that the taxpayer reasonably believes will be replaced at the end of the year, section 199 computations, deferred gain under sections 1031 and 1033 that the taxpayer reasonably believes will be replaced with qualifying property, and to any other item specifically designated in guidance published in the Internal Revenue Bulletin.

H. Taking Into Account a Section 199 Deduction

Commentators requested clarification on how taxpayers using the annualized income installment method (or the adjusted seasonal installment method) should take into account a section 199 deduction. One commentator suggested that because the section 199 deduction is calculated based on income and expense items incurred during the taxable year and has some characteristics of a credit, the final regulations should treat a section 199 deduction as a credit. Commentators also suggested that the final regulations require taxpayers to annualize income and compute the section 199 deduction based on the annualized amount. Another commentator requested that the final regulations treat a section 199 deduction as an item that substantially affects taxable income but cannot be accurately determined by the installment due date. The commentator requested that the final regulations allow taxpayers to make a reasonable estimate of the section 199 deduction for purposes of determining the proportionate amount that should be taken into account in determining annualized taxable income.

Although the section 199 deduction is calculated based on income and expense items incurred during the taxable year, the section 199 deduction is a deduction and not a credit. Therefore, a section 199 deduction must be taken into account to reduce taxable income, not to reduce tax. Under the final regulations, a section 199 deduction is computed prior to annualizing the taxable income for the annualization period. However, in recognition that qualification for the section 199 deduction is restricted by various annual limitations that may not be known as of the end any specific annualization period, the final regulations provide that a section 199 deduction should be treated as an item that substantially affects taxable income but cannot be accurately determined by the installment due date. Therefore, the final regulations permit taxpayers to make a reasonable estimate of the section 199 deduction for purposes of determining the amount to be taken into account in determining annualized taxable income.

I. Section 263A Expenses

One commentator suggested that the proposed regulations do not provide rules on how taxpayers should account for section 263A adjustments to compute annualized taxable income. The commentator requested that the final regulations not require taxpayers to compute an actual section 263A adjustment for an installment period because this computation would create a significant administrative burden for taxpayers. The commentator also requested that the final regulations provide simplifying rules that allow taxpayers to compute the section 263A adjustment for an installment period by multiplying the prior year's absorption ratio by the inventory on hand at the end of the annualization period or by estimating the annual adjustment and prorating it to each annualization period.

Section 263A expenses are added to the items covered by the rules provided in § 1.6655–2(g) of the final regulations for items that substantially affect taxable income but cannot be accurately determined by the installment due date. Therefore, taxpayers may use reasonable estimates from existing data with respect to the amount of adjustments required under section 263A if that amount cannot be determined with reasonable accuracy by the installment due date.

J. LIFO

One commentator noted that although the proposed regulations provide simplifying rules to determine the internal inflation index for taxpayers using internal dollar-value LIFO inventory methods, the proposed regulations do not provide rules for taxpayers to determine an external inflation index under the inventory price index computation (IPIC) LIFO method. The commentator requested that the final regulations include a rule that allows taxpayers to determine an estimated external inflation index by multiplying the prior year inventory mix by the applicable inflation index for the annualization period. The commentator also requested that the final regulations include a rule that allows a taxpayer that elected to use final indices to use preliminary indices if the final indices for the appropriate month have not been published. The dollar-value LIFO inventory method includes the use of external indexes, such as the IPIC LIFO method, as well as internal indexes. Therefore, the IRS and Treasury Department do not believe that a separate rule is necessary for the use of external inflation indexes.

K. Advance Payment

One commentator noted that the proposed regulations do not address how a taxpayer who defers revenue either under § 1.451–5(c) or Rev. Proc. 2004–34 (2004–1 CB 991) should account for an advance payment to determine annualized taxable income. Section 1.451–5(c) and Rev. Proc. 2004–34 generally allow a taxpayer to defer recognition of a qualifying advance payment for a limited time but only to the extent that financial statements also defer recognition of the income. The commentator requested that the final regulations include a rule that allows a taxpayer using the deferral method under § 1.451–5(c) or Rev. Proc. 2004–34 to not recognize an advance payment as income in the annualization period until the advance payment is recognized in the taxpayer's applicable financial statements for the annualization period. The commentator also requested that the final regulations allow a taxpayer using a deferral method to recognize any portion of an advance payment on the last day of the taxable year in which the advance payment is required to be recognized under § 1.451–5(c) or Rev. Proc. 2004–34, if that portion of the advance payment is not recognized in the taxpayer's financial statements for any of the annualization periods arising within the limited time provided in § 1.451–5(c) or Rev. Proc. 2004–34. See § 601.601(d)(2)(ii)(*b*).

The IRS and Treasury Department agree with the commentator that the final regulations should specifically address advance payments and that the rule should be consistent with § 1.451–5 and Rev. Proc. 2004–34. Pursuant to § 1.6655–2(f)(3)(i)(A) of the final regulations, if the taxpayer uses the method of accounting provided in § 1.451–5(b)(1)(ii) for an advance payment, the advance payment is includible in computing taxable income under that method of accounting except that, if § 1.451–5(c) applies, any amount not included in computing taxable income by the end of the second taxable year following the year in which a substantial advance payment is received, and not previously included in accordance with the taxpayer's accrual method of accounting, is includible in computing taxable income on the last day of such second taxable year. In addition, § 1.6655–2(f)(3)(i)(B) of the final regulations provides that if the taxpayer uses the deferral method provided in section 5.02 of Rev. Proc. 2004–34 for an advance payment, the advance payment is includible in computing taxable income under that method of accounting for annualization purposes. But any amount not included in computing taxable income by the end of the taxable year succeeding the taxable year of receipt is includible in computing taxable income on the last day of such succeeding taxable year. The final regulations provide an example involving an advance payment.

L. Extraordinary Items

One commentator suggested that the final regulations provide special treatment for extraordinary items for purposes of computing annualized taxable income and suggested that the regulations consider the extraordinary items listed in § 1.1502–76(b)(2)(ii)(C). The commentator requested that the final regulations not require taxpayers to take into account extraordinary items under the general rules of § 1.6655–2(f) of the proposed regulations because doing so would result in a distortion of annualized taxable income. The commentator requested that extraordinary items be taken into account after annualizing taxable income. The commentator requested that the final regulations provide that taxpayers begin to account for extraordinary items in the annualization period in which the extraordinary event occurs or, alternatively, in the annualization period in which it becomes reasonably foreseeable that the extraordinary event will occur. The commentator also requested that the final regulations provide an exclusive list of extraordinary items by referring to the list of extraordinary items in § 1.1502–76(b)(2)(ii)(C) with certain modifications.

The IRS and Treasury Department agree with the commentator that the annualization of extraordinary items could result in a distortion of annualized taxable income. The final regulations include a list of extraordinary items similar to the items in § 1.1502–76(b)(2)(ii)(C). Included in the list of extraordinary items in the final regulations are NOL deductions and section 481(a) adjustments. In addition, the final regulations also provide a *de minimis* rule wherein only extraordinary items in excess of $1,000,0000 will be required to be accounted for after annualizing taxable income. However, this *de minimis* rule does not apply to NOL deductions and section 481(a) adjustments.

M. Section 481(a) Adjustments

The rule in § 1.6655–2(f)(2)(iv) of the proposed regulations provides that a taxpayer takes into account a section 481(a) adjustment related to an automatic accounting method change during an annualization period only if a copy of the Form 3115, ''Application for Change in Accounting Method'', has been mailed to the IRS National Office on or before the last day of the annualization period. One commentator suggested that the rule provided by § 1.6655–2(f)(2)(iv) of the proposed regulations creates administrative burdens for taxpayers, is inconsistent with the depreciation and amortization rules provided in § 1.6655–2(f)(2)(v) of the proposed regulations, and could result in the filing of incomplete Forms 3115. The commentator suggested that the rule in § 1.6655–2(f)(2)(iv)(B)(*1*) of the proposed regulations causes an administrative burden by requiring taxpayers to recompute taxable income using a different method of accounting than would be used to calculate taxpayers' tax provision for financial accounting purposes, which generally allows taxpayers to take into account section 481(a) adjustments for an automatic accounting method change if they anticipate that the change will be timely filed. The commentator also suggested that if the final regulations adopt the rule in § 1.6655–2(f)(2)(v) of the proposed regulations that allows taxpayers to anticipate capital expenditures to estimate depreciation expense for an annualization period, the final regulations should provide a similar rule for automatic accounting method changes by allowing taxpayers to take into account section 481(a) adjustments resulting from anticipated filings for automatic accounting method changes.

The final regulations provide that, in general, any section 481(a) adjustment that results from a change in accounting method that is approved by the Commissioner and properly reflected in the taxpayer's return for the tax year is taken into account as an extraordinary item deemed to occur on the first day of the tax year for annualization purposes. The final regulations provide that a section 481(a) adjustment may be taken into account in this manner notwithstanding (i) the annualization period in which the Form 3115 is filed (including requests filed after year-end), (ii) whether the requested change in accounting method is considered an automatic or non-automatic accounting method change request, (iii) whether the section 481(a) adjustment is positive or negative, and (iv) the date on which the taxpayer receives the approval of the Commissioner. In allowing for a section 481(a) adjustment to be taken into account in this manner, taxpayers should be aware that they will be subject to a section 6655 addition to tax for an underpayment of estimated tax in an installment period caused from taking into account a section 481(a) adjustment the taxpayer expected to be incurred but for which the taxpayer does not receive the consent of the Commissioner to change its method of accounting for that particular tax year. The final regulations also provide an exception to the general rule. Under the exception a taxpayer may choose to treat the filing of a Form 3115 as the date on which the extraordinary item is deemed to occur rather than the first day of the tax year but only with respect to the section 481(a) adjustment (or a portion thereof) that is recognized in the year of change. Use of this exception will impact the period in which the taxpayer will be required to take into account the new method of accounting as provided in § 1.6655–6.

N. Simplify the 52/53 Week Taxable Year Rules

One commentator suggested that the 52/53 week taxable year rules provided by § 1.6655–2(e) of the proposed regulations are too complex and administratively burdensome. The commentator suggested that the final regulations not include the 52/53 week taxable year rules in § 1.6655–2(e) of the proposed regulations and rely on the general concept of annualization. The commentator suggested that taxpayers with 52/53 week taxable years under section 441(f) know how to annualize their applicable annualization period without the rules provided by § 1.6655–2(e) of the proposed regulations.

The purpose of the annualized income installment method is to give taxpayers a method of determining annualized income based on the actual facts that occur in the annualization period. Therefore, with limited exceptions, the IRS and Treasury Department drafted the proposed regulations and these final regulations to provide rules that only allow taxpayers to take into account items of income and expense that arise in the applicable annualization period. The IRS and Treasury Department recognize that the 52/53 week taxable year rules provided by § 1.6655–2(e) of the proposed regulations are complex. Although the final regulations retain the 52/53 week taxable year rules provided by § 1.6655–2(e) of the proposed regulations, the final regulations also provide a safe harbor that allows a taxpayer with a 52/53 week taxable year to determine its annualization period on the month that ends closest to the end of its applicable thirteen-week period or four-week period that ends within the applicable annualization period. However, an eligible taxpayer may only use this safe harbor if it is used for determining annualization periods for all required installments for the taxable year.

O. Controlled Foreign Corporations, Partnerships, and Other Pass-Through Entities

One commentator suggested that the final regulations provide rules on how taxpayers should take into account distributions from a section 936 corporation or a controlled foreign corporation to determine annualized taxable income for an installment period. The commentator also suggested that the final regulations provide rules on how taxpayers should take into account a distributive share of income from passthrough entities other than partnerships, such as trusts, S corporations, and real estate investment trusts (REITs), to determine annualized taxable income for an installment period. The commentator requested that the final regulations expand the scope of § 1.6655–2(f)(2)(vi) of the proposed regulations to incorporate the statutory provisions for section 936(h), section 951(a), and closely held REITs, and also provide rules to take into account the distributive share of income received from other types of passthrough entities.

Section 1.6655–2(f)(3)(v) of the final regulations expands the rule in § 1.6655–2(f)(2)(vi) of the proposed regulations to provide for the statutory rules in section 6655(e)(4) and section 6655(e)(5) for taking into account subpart F income, income under section 936(h), and dividends received by closely held REITs when computing any annualized income installment. In addition, § 1.6655–2(f)(3)(v)(D) adds a rule that requires items from passthrough entities other than partnerships and closely held REITs to be taken into account in computing any annualized income installment in a manner similar to the manner under which partnership items are taken into account under § 1.6655–2(f)(3)(v)(A) of the final regulations.

3. Comments Concerning § 1.6655–3 (Adjusted Seasonal Installment Method) of the Proposed Regulations

A. Adjusted Seasonal Installment Method and Alternative Minimum Tax

One commentator suggested that the determination of whether a corporation qualifies for the adjusted seasonal installment method under section 6655(e)(3), and the amount of the required installment under this method, is based only on the corporation's taxable income and tax on that taxable income. The commentator requested that the final regulations clarify that a corporation using the adjusted seasonal installment method is only required to make estimated tax payments with respect to taxable income and tax on that taxable income, and not on the alternative minimum tax (AMT) or any other tax. Any required installment must include AMT because AMT is included in the definition of tax in section 6655(g)(1) and § 1.6655–1(g)(1) of the final regulations. Including AMT in the determination of tax is consistent with the general annualization method and adjusted seasonal installment method and recognizes the overall separate and parallel nature of the AMT. Therefore, § 1.6655–3(d)(4) of the final regulations provides that the amount of an installment determined using the adjusted seasonal installment method must properly take into account the amount of any AMT under section 55 that would apply for the period of the computation. For this purpose, the amount of any AMT that would apply is determined by applying to alternative minimum taxable income, tentative minimum tax, and AMT, the rules provided in § 1.6655–3(c) of the final regulations for determining the amount of an installment using the adjusted seasonal installment method.

B. Adjusted Seasonal Installment Method Base Period Percentage

Section 6655(e)(3)(D)(i) provides that the base period percentage for any period of months is the average percent that the taxable income for the corresponding months in each of the 3 preceding taxable years bears to the taxable income for the 3 preceding taxable years. One commentator requested that the final regulations clarify whether the base period percentage provided in § 1.6655–3(d)(1) of the proposed regulations can be negative.

The rule provided in section 6655(e)(3)(D)(i) requires that the base period percentage be computed based on taxable income. The rule does not provide that taxpayers take into account a loss. Therefore, a taxpayer can never have a negative base period percentage. The lowest number the base period percentage can equal is zero. Section 1.6655–3(d)(1) of the final regulations provides that the base period percentage is computed based on taxable income, which the IRS and Treasury Department believe provides a clear rule that an overall loss for the applicable period of months used to calculate the base period percentage cannot be used to compute the base period percentage. If a taxpayer has an overall loss for an applicable period of months used in the computation of the base period percentage, the taxpayer must use zero in place of the loss.

4. Comments Concerning § 1.6655–4 (Large Corporations) of the Proposed Regulations

A. Section 381 Transactions to Determine Large Corporation Status

One commentator requested that the final regulations modify the rules in § 1.6655–4(c)(2) of the proposed regulations to clarify that, when computing taxable income for a year in which there is a section 381 transaction to determine if a corporation is a large corporation, the adjustment for the section 381 transaction relates only to the portion of taxable income applicable to the transferred assets.

Generally, for a transaction to qualify under section 381, an acquiring corporation must acquire a majority of the assets of the acquired corporation. Section 1.6655–4(c)(2) of the proposed regulations provides that when determining if a corporation is a large corporation for a taxable year in which a section 381 transaction occurs, an acquiring corporation must include in its income the distributor or transferor corporation's income for the taxable year up to and including the date of distribution or transfer. This rule requires the acquiring corporation to include 100 percent of the distributor or transferor corporation's taxable income (or loss) in the acquiring corporation's income even if the acquiring corporation acquires less than 100 percent of the assets of the distributor or transferor corporation as long as section 381 applies to the transaction. The final regulations do not include a rule providing that the adjustment for a section 381 transaction relates only to the portion of taxable income applicable to the transferred assets when computing taxable income for a year in which there is a section 381 transaction to determine if a corporation is a large corporation. The IRS and Treasury Department believe that such a rule would be unnecessarily complex considering that the rule in the proposed regulations is both taxpayer favorable (if there are losses of the distributor or transferor corporation) and taxpayer unfavorable (if there is taxable income of the distributor or transferor corporation) and considering that in these transactions, the acquiring corporation generally acquires a majority of the distributor or transferor corporation's assets. However, § 1.6655–4(c)(2)(i)(B) of the final regulations amends § 1.6655–4(c)(2)(i)(B) of the proposed regulations to clarify that an acquiring corporation takes into account the distributor or transferor corporation's taxable income or loss for purposes of determining whether a corporation is a large corporation for a taxable year in which a section 381 transaction occurs.

B. Aggregation

One commentator suggested that the rule provided by § 1.6655–4(d)(2) of the proposed regulations, which does not allow taxpayers to take into account a taxable loss of a member of a controlled group of corporations for a taxable year during the testing period, results in a distorted view of the taxable income of the controlled group of corporations. The commentator requested that the final regulations modify the rule in § 1.6655–4(d)(2) of the proposed regulations to allow taxpayers to take into account losses of a member of a controlled group of corporations when determining whether a corporation is considered a large taxpayer because this is consistent with the principles for the computation of consolidated taxable income.

Section 6655(g)(2)(B)(ii) requires that the $1,000,000 exemption be divided among members of a controlled group under rules similar to the rules of section 1561. The purpose of the statute is to limit members of a controlled group, as an aggregate, to $1,000,000 of exemption from large corporation treatment. The aggregation rule in § 1.6655–4(d)(2) is intended to allow a controlled group to quickly determine whether the controlled group must allocate the $1,000,000 limitation among the members of the group. It is not intended to treat the controlled group as a single taxpayer, in which all members of the group will be treated as a large corporation, if the taxable income of the controlled group, as an aggregate, is over $1,000,000. Thus, for example, if member A of a controlled group had taxable income of $900,000 and member B of the group had taxable income greater than $1,000,000, the controlled group could choose to allocate $900,000 to member A so that member A will not be treated as a large corporation, but member B would be treated as a large corporation no matter how much of the $1,000,000 limitation is allocated to member B. This is consistent with the rules under section 1561.

5. Comments Concerning § 1.6655–5 (Short Taxable Years) of the Proposed Regulations

A. Taxpayer's Initial Taxable Year

One commentator noted that a taxpayer is not required to choose its taxable year until it files a tax return on its chosen basis in accordance with § 1.441–1(c)(1). The commentator requested that the final regulations modify the rule in § 1.6655–5(c)(1)(ii) of the proposed regulations to provide that a taxpayer will not be penalized if, in its initial taxable year, it makes estimated tax payments based on a presumption that the taxpayer will have a taxable year that is a calendar year even if the taxpayer subsequently chooses a fiscal year.

Because a taxpayer has until the date it files its initial tax return to choose its taxable year, the final regulations modify the rule in § 1.6655–5(c)(1)(ii) of the proposed regulations to allow a taxpayer with an initial short taxable year to make estimated tax payments as though it chose to be a calendar year taxpayer until the taxpayer files its return for its initial short taxable year. Pursuant to this modified rule, a taxpayer with an initial short taxable year may make estimated tax payments as though it were a calendar year taxpayer until it files its tax return for its initial taxable year.

B. Taxpayer's Final Taxable Year

One commentator suggested that §§ 1.6655–5(d)(1), 1.6655–5(d)(2), and 1.6655–5(d)(3) of the proposed regulations provide rules that may require taxpayers with short taxable years to make installment payments based on an applicable percentage that is more than the standard 25 percent per installment period. The commentator suggested that these rules may result in a section 6655 addition to tax being imposed on a taxpayer who makes annualization payments based on 25 percent of its annualized tax and later in the year discovers that, due to an unforeseen termination of its tax year, it should have made its annualization payments based on a higher applicable percentage because it will have fewer than four installment payments. The commentator also suggested that the rule in § 1.6655–2(h) of the proposed regulations, which addresses events arising after an installment due date that were not reasonably foreseeable, does not appear to protect a taxpayer that makes an installment payment based on 25 percent of its annualized tax and later discovers that it should have based its installment payment on a higher applicable percentage because it had an unforeseen termination of its tax year resulting in a short taxable year. The commentator requested that the final regulations revise the rules in §§ 1.6655–5(d)(1), 1.6655–5(d)(2), and 1.6655–5(d)(3) of the proposed regulations so that payments made for an installment period in a short taxable year do not exceed 25 percent. As an alternative, the commentator requested that the final regulations revise the rules in § 1.6655–2(h) of the proposed regulations to allow a taxpayer with an unexpected termination of its tax year to make a payment with its final required installment equal to the remaining portion of 100 percent of its required annual payment to avoid a penalty on its earlier required installments.

A taxpayer should not be penalized for making payments based on the applicable percentage of 25 percent for each installment period when it does not know that it will have an early termination year that will result in it making less than four installment payments. Therefore, § 1.6655–5(d)(4) of the final regulations provides a rule addressing the applicable percentage for an installment period in which the taxpayer does not reasonably expect that the taxable year will be an early termination year. In the case of any required installment determined under section 6655(e) in which the taxpayer does not know that the taxable year will be an early termination year, the applicable percentage under section 6655(e)(2)(B)(ii) and § 1.6655–5(d)(3)(i) of the final regulations is the applicable percentage for each installment period with the remaining balance of the estimated tax payment for the year due with the final installment.

C. Internal Revenue Manual Provisions and Annualizing Taxable Income in an Initial or Final Taxable Year

One commentator noted that Internal Revenue Manual Part 20.1.3.6.3(2) provides that a corporation filing a short period return that is either an initial or final return is not required to annualize its taxable income to compute the penalty. The commentator requested that the final regulations clarify this rule.

The rule in IRM 20.1.3.6.3(2) provides that if a taxpayer has a short taxable year that is either an initial or final year, the taxpayer should not annualize its taxable income based on a full 12 month period. Instead, the taxpayer should annualize its taxable income based on the number of months in the short taxable year. This rule was intended to be provided in § 1.6655–5(g)(2) of the proposed regulations. However, the computational rule in § 1.6655–5(g)(2) of the proposed regulations is incorrect and does not result in the computation of the correct amount for every installment payment during a short taxable year. The final regulations revise the rule in § 1.6655–5(g)(2) of the proposed regulations to provide that a taxpayer computes its annualized income installment by determining the tax on the basis of the annualized income for the annualization period, dividing the resulting tax by 12, multiplying that result by the number of months in the short taxable year, and finally multiplying that result by the applicable percentage for the annualized income installment. The final regulations also revise an example to reflect the new computational rule.

D. Preceding Taxable Year Rule for Large Corporations When the Preceding Taxable Year Is a Short Year

One commentator suggested that the rule provided in § 1.6655–5(h) of the proposed regulations, which requires taxpayers to compute the preceding year tax on an annual basis if the preceding taxable year was a short taxable year when using section 6655(d)(2) to determine their first installment, is not authorized by section 6655. Consistent with § 1.6655–1(g)(3), the final regulations do not adopt the rule provided in § 1.6655–5(h) of the proposed regulations.

6. Change in Method of Accounting

The rule in § 1.6655–6(b) of the proposed regulations provides that if a taxpayer is making a change in method of accounting for the current taxable year that is permitted to be made with the automatic consent of the Commissioner, the new method is used in determining any required installment if, and only if, a copy of the Form 3115 has been mailed to the IRS National Office on or before the last day of the annualization period. One commentator suggested that the rule provided by § 1.6655–6(b) of the proposed regulations creates administrative burdens for taxpayers, is inconsistent with the depreciation and amortization rules provided in § 1.6655–2(f)(2)(v) of the proposed regulations, and could result in the filing of incomplete Forms 3115. The commentator suggested that the rule in § 1.6655–6(b) of the proposed regulations causes an administrative burden by requiring taxpayers to recompute taxable income using a different method of accounting than would be used to calculate taxpayers' tax provision for financial accounting purposes, which generally allows taxpayers to take into account an automatic accounting method change if they anticipate that the change will be timely filed.

Consistent with the rules for section 481(a) adjustments as discussed in heading (2)(M) above, the final regulations require a taxpayer to take into account any change in method of accounting for which the taxpayer has received the consent of the Commissioner in the same manner the taxpayer chooses to treat the section 481(a) adjustment resulting from such a change (for example, as of the first day of the taxable year or as of the date the Form 3115 was filed). For a change in accounting method that does not result in a section 481(a) adjustment, the final regulations provide that in the year of change the taxpayer will have the choice for annualization purposes to either use the new method as of the first day of the taxable year or as of the date the Form 3115 was filed.

Effect on Other Documents

The following publications are obsolete for tax years beginning after September 6, 2007:

Revenue Ruling 67–93 (1967–1 CB 366).

Revenue Ruling 76–450 (1976–2 CB 444).

Revenue Ruling 78–257 (1978–1 CB 440).

Revenue Ruling 67–93 (1967–1 CB 366) provides that the entire amount of a net operating loss carryover should be deducted from income prior to annualization under the annualized income installment method. The rational underlying the conclusion in Rev. Rul. 67–93 was based on the position that each annualization period should be treated as a short taxable year. The final regulations specifically provide that an annualization period is not treated as a short taxable year. Therefore, Rev. Rul. 67–93 will be removed when the final regulations are effective.

Revenue Ruling 76–450 (1976–2 CB 444) provides that state property tax and franchise tax are deductible from the income for an annualization period on the date the taxpayer accrues the taxes under the taxpayer's method of accounting. Revenue Ruling 76–450 was issued prior to the enactment of section 461(h) and does not take into account the application of the economic performance requirements of section 461(h) for purposes of computing an estimated tax payment using the annualized income installment method. The final regulations provide specific rules related to address the application of section 461(h) and real property taxes for purposes of the annualized income installment method. As a result of the rules provided in the final regulations, Rev. Rul. 76–450 is no longer applicable and will be removed when the final regulations are effective. See § 601.601(d)(2)(ii)(*b*).

Revenue Ruling 78–257 (1978–1 CB 440) provides that the term tax, as defined in section 6655, includes the amount of tax resulting from the recomputation of a prior year's investment credit at the applicable rate for the current year. In Rev. Rul. 78–257, a corporation incurred a net operating loss in 1975 but showed an amount of tax from the recomputation of the prior year's investment credit. For 1976 the corporation had a liability for income tax but made no deposits of estimated tax, relying on the former provision in section 6655 that allowed a taxpayer to base its estimated tax payments on an amount equal to the tax computed at the rates applicable to the taxable year but otherwise on the basis of the facts shown on the return of the corporation for, and the law applicable to, the preceding taxable year. The revenue ruling concludes that the corporation was subject to an addition to tax for the underpayment of estimated tax because it failed to pay on or before the prescribed installment due dates an amount equal to the tax resulting from the recomputation of the prior year's investment credit. However, as discussed in heading (1)(A) of the preamble, based on the holding in *Berkshire Hathaway, Inc.* v. *United States,* 802 F.2d 429 (Fed. Cir. 1986), § 1.6655–1(g)(1)(iii) of the final regulations provides that, unless otherwise provided, for purposes of the definition of *tax* as used in section 6655, a recapture of tax, such as a recapture provided by section 50(a)(1)(A) and any other similar provision, is not considered to be a tax imposed by section 11. Therefore, Rev. Rul. 78–257 is no longer applicable and will be removed when the final regulations are effective. See § 601.601(d)(2)(ii)(*b*).

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. Except with respect to § 1.6655–5, which deals with the rules applicable to a short taxable year, it has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations and, because these provisions do not impose a collection of information on small businesses, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. With respect to § 1.6655–5, it is hereby certified that this provision of the regulations will not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that not many small businesses are going to be subject to the short taxable year rules because: (1) Existing small businesses generally are not targets of mergers and acquisitions, which result in a short taxable year; (2) start-up small businesses with a short taxable year of less than four months do not have to pay estimated taxes; and (3) start-up small businesses with a short taxable year of four months or more are not likely to have taxable income that would be subject to the corporate estimated tax rules. Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking preceding this regulation was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small businesses.

Drafting Information

The principal authors of these regulations are Joseph P. Dewald, formerly of the Office of Associate Chief Counsel (Procedure and Administration), and Timothy S. Sheppard, Office of Associate Chief Counsel (Procedure and Administration).

List of Subjects

26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

26 CFR Part 301

Employment taxes, Estate taxes, Excise taxes, Gift taxes, Income taxes, Penalties, Reporting and recordkeeping requirements.

26 CFR Part 602

Reporting and recordkeeping requirements.

Adoption of Amendments to the Regulations

■ Accordingly, 26 CFR parts 1, 301, and 602 are amended as follows:

PART 1—INCOME TAXES

■ **Paragraph 1.** The authority citation for part 1 is amended by adding an entry in numerical order to read as follows:

Authority: 26 U.S.C. 7805 * * *

Section 1.6655–5 also issued under 26 U.S.C. 6655(i)(2). * * *

■ **Par. 2.** In § 1.56–0, the heading for paragraph (e)(5) is added to read as follows:

§ 1.56–0 Table of contents to § 1.56–1, adjustment for book income of corporations.

* * * * *

(e) * * *

(5) Effective/applicability date.

■ **Par. 3.** Section 1.56–1(e)(4) is revised and paragraph (e)(5) is added to read as follows:

§ 1.56–1 Adjustment for the book income of corporations.

* * * * *

(e) * * *

(4) *Estimating the book income adjustment for purposes of the estimated tax liability.* See § 1.6655–7, as contained in 26 CFR part 1 revised as of April 1, 2007, for special rules for estimating the corporate alternative

minimum tax book income adjustment under the annualization exception.

(5) *Effective/applicability date.* Paragraph (e)(4) of this section is applicable for taxable years beginning after September 6, 2007.

§§ 1.6154–1, 1.6154–2, 1.6154–3, 1.6154–4, and 1.6154–5 [Removed].

■ **Par. 4.** Sections 1.6154–1, 1.6154–2, 1.6154–3, 1.6154–4, and 1.6154–5 are removed.

■ **Par. 5.** Section 1.6425–2(a) is revised and paragraph (c) is added to read as follows:

§ 1.6425–2 Computation of adjustment of overpayment of estimated tax.

(a) *Income tax liability defined.* For purposes of § 1.6425–1, this section, §§ 1.6425–3 and 1.6655–7, relating to excessive adjustment, the term *income tax liability* means the excess of—

(1) The sum of—

(i) The tax imposed by section 11 or 1201(a), or subchapter L of chapter 1 of the Internal Revenue Code, whichever is applicable; plus

(ii) The tax imposed by section 55; over

(2) The credits against tax provided by part IV of subchapter A of chapter 1 of the Internal Revenue Code.

* * * * *

(c) *Effective/applicability date.* Paragraph (a) of this section is applicable to applications for adjustments of overpayments of estimated income tax that are filed in taxable years beginning after September 6, 2007.

■ **Par. 6.** Section 1.6425–3 is amended by revising paragraph (f) to read as follows:

§ 1.6425–3 Allowance of adjustments.

* * * * *

(f) *Effect of adjustment.* (1) For purposes of all sections of the Internal Revenue Code except section 6655, relating to additions to tax for failure to pay estimated income tax, any adjustment under section 6425 is to be treated as a reduction of prior estimated tax payments as of the date the credit is allowed or the refund is paid. For the purpose of sections 6655(a) through (g), (i), and (j), credit or refund of an adjustment is to be treated as if not made in determining whether there has been any underpayment of estimated income tax and, if there is an underpayment, the period during which the underpayment existed. However, an excessive adjustment under section 6425 is taken into account in applying the addition to tax under section 6655(h).

(2) For the effect of an excessive adjustment under section 6425, see § 1.6655–7.

(3) *Effective/applicability date:* This paragraph (f) is applicable to applications for adjustments of overpayments of estimated income tax that are filed in taxable years beginning after September 6, 2007.

■ **Par. 7.** Section 1.6655–0 is added to read as follows:

§ 1.6655–0 Table of contents.

This section lists the table of contents for §§ 1.6655–1 through 1.6655–7.

§ 1.6655–1 Addition to the tax in the case of a corporation.

(a) In general.
(b) Amount of underpayment.
(c) Period of the underpayment.
(d) Amount of required installment.
(1) In general.
(2) Exception.
(e) Large corporation required to pay 100 percent of current year tax.
(1) In general.
(2) May use last year's tax for first installment.
(f) Required installment due dates.
(1) Number of required installments.
(2) Time for payment of installments.
(i) Calendar year.
(ii) Fiscal year.
(iii) Short taxable year.
(iv) Partial month.
(g) Definitions.
(h) Special rules for consolidated returns.
(i) Overpayments applied to subsequent taxable year's estimated tax.
(1) In general.
(2) Subsequent examinations.
(j) Examples.
(k) Effective/applicability date.

§ 1.6655–2 Annualized income installment method.

(a) In general.
(b) Determination of annualized income installment—in general.
(c) Special rules.
(1) Applicable percentage.
(2) Partial month.
(3) Annualization period not a short taxable year.
(d) Election of different annualization periods.
(e) 52–53 week taxable year.
(f) Determination of taxable income for an annualization period.
(1) In general.
(i) Items of income.
(ii) Items of deduction.
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(2) Certain deductions required to be allocated in a reasonably accurate manner.
(i) In general.
(ii) Application of the reasonably accurate manner requirement to certain charitable contributions, recurring items, and 12-month rule items.
(iii) Reasonably accurate manner defined.
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(v) Examples.
(3) Special rules.
(i) Advance payments.
(A) Advance payments under § 1.451–5(b)(1)(ii).
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(ii) Extraordinary items.
(A) In general.
(B) De minimis extraordinary items.
(C) Special rules for net operating loss deductions and section 481(a) adjustments.
(iii) Credits.
(A) Current year credits.
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(B) Safe harbors.
(*1*) Proportionate depreciation allowance.
(*2*) 90 percent of preceding year's depreciation.
(*3*) Safe harbor operational rules.
(C) Short taxable years.
(v) Distributive share of items
(A) Member of partnership.
(B) Treatment of subpart F income and income under section 936(h).
(*1*) General rule.
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(C) Dividends from closely held real estate investment trust.
(*1*) General rule.
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(vi) Alternative minimum taxable income exemption amount.
(vii) Examples.
(g) Items that substantially affect taxable income but cannot be determined accurately by the installment due date.
(1) In general.
(2) Example.
(h) Effective/applicability date.

§ 1.6655–3 Adjusted seasonal installment method.

(a) In general.
(b) Limitation on application of section.
(c) Determination of amount.
(d) Special rules.
(1) Base period percentage.
(2) Filing month.
(3) Application of the rules related to the annualized income installment method to the adjusted seasonal installment method.
(4) Alternative minimum tax.
(e) Example.
(f) Effective/applicability date.

§ 1.6655–4 Large corporations.

(a) Large corporation defined.
(b) Testing period.
(c) Computation of taxable income during testing period.
(1) Short taxable year.
(2) Computation of taxable income in taxable year when there occurs a transaction to which section 381 applies.
(d) Members of controlled group.
(1) In general.
(2) Aggregation.
(3) Allocation rule.

(4) Controlled group members.
(e) Effect on a corporation's taxable income of items that may be carried back or carried over from any other taxable year.
(f) Consolidated returns. [Reserved]
(g) Example.
(h) Effective/applicability date.
§ 1.6655–5 Short taxable year.
(a) In general.
(b) Exception to payment of estimated tax.
(c) Installment due dates.
(1) In general.
(i) Taxable year of at least four months but less than twelve months.
(ii) Exceptions.
(2) Early termination of taxable year.
(i) In general.
(ii) Exception.
(d) Amount due for required installment.
(1) In general.
(2) Tax shown on the return for the preceding taxable year.
(3) Applicable percentage.
(4) Applicable percentage for installment period in which taxpayer does not reasonably expect that the taxable year will be an early termination year.
(e) Examples.
(f) 52 or 53 week taxable year.
(g) Use of annualized income or seasonal installment method.
(1) In general.
(2) Computation of annualized income installment.
(3) Annualization period for final required installment.
(4) Examples.
(h) Effective/applicability date.
§ 1.6655–6 Methods of accounting.
(a) In general.
(b) Accounting method changes.
(c) Examples.
(d) Effective/applicability date.
§ 1.6655–7 Addition to tax on account of excessive adjustment under section 6425.

■ **Par. 8**. Sections 1.6655–1 and 1.6655–2 are revised to read as follows:

§ 1.6655–1 Addition to the tax in the case of a corporation.

(a) *In general.* Section 6655 imposes an addition to the tax under chapter 1 of the Internal Revenue Code in the case of any underpayment of estimated tax by a corporation. An addition to tax due to the underpayment of estimated taxes is determined by applying the underpayment rate established under section 6621 to the amount of the underpayment, for the period of the underpayment. This addition to the tax is in addition to any applicable criminal penalties and is imposed whether or not there was reasonable cause for the underpayment.

(b) *Amount of underpayment.* The amount of the underpayment for any required installment is the excess of—

(1) The required installment; over

(2) The amount, if any, of the installment paid on or before the last date prescribed for such payment.

(c) *Period of the underpayment.* The period of the underpayment of any required installment runs from the date the installment was required to be paid to the 15th day of the 3rd month following the close of the taxable year, or to the date such underpayment is paid, whichever is earlier. For purposes of determining the period of the underpayment a payment of estimated tax will be credited against unpaid required installments in the order in which such installments are required to be paid.

(d) *Amount of required installment*—(1) *In general.* Except as otherwise provided in this section and §§ 1.6655–2 through 1.6655–7, the amount of any required installment is 25 percent of the lesser of—

(i) 100 percent of the tax shown on the return for the taxable year (or, if no return is filed, 100 percent of the tax for such year); or

(ii) 100 percent of the tax shown on the return for the preceding taxable year.

(2) *Exception.* This paragraph (d)(1)(ii) does not apply if the preceding taxable year was not a taxable year of 12 months or the corporation did not file a return for the preceding taxable year showing a liability for tax.

(e) *Large corporation required to pay 100 percent of current year tax*—(1) *In general.* Except as provided in paragraph (e)(2) of this section, paragraph (d)(1)(ii) of this section does not apply in the case of a large corporation (as defined in § 1.6655–4).

(2) *May use last year's tax for first installment.* Paragraph (e)(1) of this section does not apply for purposes of determining the amount of the 1st required installment for any taxable year. Any reduction in such 1st installment by reason of the preceding sentence is recaptured by increasing the amount of the next required installment determined under paragraph (d)(1)(i) of this section by the amount of such reduction and, if the next required installment is reduced by use of the annualized income installment method under § 1.6655–2 or the adjusted seasonal installment method under § 1.6655–3, by increasing subsequent required installments determined under paragraph (d)(1)(i) of this section to the extent that the reduction has not previously been recaptured.

(f) *Required installment due dates*—(1) *Number of required installments.* Unless otherwise provided, corporations must make 4 required installments for each taxable year.

(2) *Time for payment of installments*—(i) *Calendar year.* Unless otherwise provided, in the case of a calendar year taxpayer, the due dates of the required installments are as follows:

1st April 15
2nd June 15
3rd September 15
4th December 15

(ii) *Fiscal year.* In the case of a taxpayer other than a calendar year taxpayer, the due dates of the required installments are as follows:

1st 15th day of 4th month of the taxable year
2nd 15th day of 6th month of the taxable year
3rd 15th day of 9th month of the taxable year
4th 15th day of 12th month of the taxable year

(iii) *Short taxable year.* See § 1.6655–5 for rules regarding required installments for corporations with a short taxable year.

(iv) *Partial month.* Except as otherwise provided, for purposes of determining the due date of any required installment, a partial month is treated as a full month.

(g) *Definitions.* (1) The term *tax* as used in this section and §§ 1.6655–2 through 1.6655–7 means the excess of—

(i) The sum of—

(A) The tax imposed by section 11, section 1201(a), or subchapter L of chapter 1 of the Internal Revenue Code, whichever is applicable;

(B) The tax imposed by section 55; plus

(C) The tax imposed by section 887; over

(ii) The credits against tax provided by part IV of subchapter A of chapter 1 of the Internal Revenue Code.

(2)(i) In the case of a foreign corporation subject to taxation under section 11, section 1201(a), or subchapter L of chapter 1 of the Internal Revenue Code, the tax imposed by section 881 is treated as a tax imposed by section 11.

(ii) In the case of a partnership that is treated, pursuant to regulations issued under section 1446(f)(2), as a corporation for purposes of this section, the tax imposed by section 1446 is treated as a tax imposed by section 11.

(iii) Unless otherwise provided in the Internal Revenue Code or Treasury regulations, for purposes of the definition of ''tax'' as used in this section, a recapture of tax, such as a recapture provided by section 50(a)(1)(A), and any other similar provision, is not considered to be a tax imposed by section 11.

(iv) For the purposes of paragraph (d) of this section, the return for the preceding taxable year is the Federal income tax return for such taxable year that is required by section 6012(a)(2). However, if an amended Federal income tax return has been filed before the due date of an installment, then the return for the preceding taxable year is the Federal income tax return as amended. If an amended Federal income tax return has been filed on or after the due date for an installment, then the return for the preceding taxable year does not include for such installment period the Federal income tax return as amended subsequent to the due date for such installment. Paragraph (d) of this section will apply without regard to whether the taxpayer's Federal income tax return for the preceding taxable year is filed in a timely manner.

(h) *Special rules for consolidated returns* For special rules relating to the determination of the amount of the underpayment in the case of a corporation whose income is included in a consolidated return, see § 1.1502–5(b).

(i) *Overpayments applied to subsequent taxable year's estimated tax*—(1) *In general.* If a taxpayer elects under the provisions of sections 6402(b) and 6513(d) and the regulations to apply an overpayment in year one against the estimated tax liability for year two, the overpayment will be applied to the required installment payments for year two in the order due and to the extent necessary to satisfy such installments, similar to the manner in which an actual overpayment of one installment is carried forward to the next installment. No interest is accrued or paid on an overpayment if the election to apply the overpayment against estimated tax is made.

(2) *Subsequent examinations.* If a deficiency is determined in an examination of a return for a taxable year that originally reflected an overpayment that was applied against estimated tax for the succeeding taxable year, interest on the deficiency will not begin to accrue on an amount applied until that amount is used to satisfy a required estimated tax payment in such taxable year. Regardless of whether the taxpayer anticipated the application of such overpayment from the prior taxable year in calculating and paying its required estimated tax installment liabilities for the current taxable year, the subsequently determined underpayment and interest computation thereon will not change the taxpayer's original election to apply the overpayment against the estimated tax liability of the succeeding taxable year. Any changes to the usage of the original overpayment from the prior taxable year are hypothetical only and solely for the purpose of computing deficiency interest. Overpayment interest will not be impacted. For further guidance, see Rev. Rul. 99–40 (1999–2 CB 441), (see § 601.601(d)(2)(ii)(*b*) of this chapter).

(j) *Examples.* The method prescribed in paragraphs (d) through (g) of this section is illustrated by the following examples:

Example 1. (i) X, a calendar year corporation, estimates its tax liability for its taxable year ending December 31, 2009, will be $85,000. X is not a large corporation as defined in section 6655(g)(2) and § 1.6655–4. X reported a liability of $74,900 on its return for the taxable year ended December 31, 2008, with no credits against tax. X paid four installments of estimated tax, each in the amount of $18,725 (25 percent of $74,900), on April 15, 2009, June 15, 2009, September 15, 2009, and December 15, 2009, respectively. X reported a tax liability of $88,900 on its return due March 15, 2010. X had a $5,000 credit against tax for tax year 2009 as provided by part IV of subchapter A of chapter 1 of the Internal Revenue Code. X did not underpay its estimated tax for tax year 2009 for any of the four installments, determined as follows:

(A) Tax as defined in paragraph (g) of this section for 2009 ($88,900-$5,000) = $83,900

(B) Tax as defined in paragraph (g) of this section for 2008 = $74,900

(C) 100% of the lesser of this paragraph (j), *Example 1* (i)(A) or (i)(B) = $74,900

(D) Amount of estimated tax required to be paid on or before each installment date (25% of $74,900) = $18,725

(E) Deduct amount paid on or before each installment date = $18,725

(F) Amount of underpayment for each installment date = $0

(ii) [Reserved].

Example 2. (i) *Facts.* Y, a calendar year corporation, estimates its tax liability for its taxable year ending December 31, 2009, will be $70,000. Y is not a large corporation as defined in section 6655(g)(2) and § 1.6655–4. Y reported a Federal income tax liability of $90,000 for its taxable year ending December 31, 2008. Y paid no installment of estimated tax on or before April 15, 2009, June 15, 2009, or September 15, 2009, but made a payment of $63,000 on December 15, 2009. On March 15, 2010, Y filed its income tax return showing a tax of $70,000. Y had no credits against tax for tax year 2009. Of the $63,000 paid by Y on December 15, 2009, $17,500 is applied to each of the first three installments due on April 15, June 15, and September 15, 2009, and the remaining $10,500 is applied to the fourth installment. Y has an underpayment of estimated tax for each of the first three installments of $17,500 and for the fourth installment of $7,000. The addition to tax under section 6655(a) is computed as follows:

(A) Tax as defined in paragraph (g) of this section for 2009 = $70,000

(B) Tax as defined in paragraph (g) of this section for 2008 = $90,000

(C) 100% of the lesser of this paragraph (j), *Example 2* (i)(A) or (i)(B) = $70,000

(D) Amount of estimated tax required to be paid on or before each installment date (25% of $70,000) = $17,500

(E) Amount paid on or before the first, second, and third installment dates = $0

(F) Amount paid on or before the fourth installment date = $63,000

(G) Amount of underpayment for each of the first, second, and third installment dates = $17,500

(H) Amount of underpayment for the fourth installment date = $7,000

(ii) *Addition to tax.* Assuming that neither the annualized income installment method nor the adjusted seasonal installment method described in §§ 1.6655–2 and 1.6655–3 would result in a lower payment for any installment period, and the addition to tax is computed under section 6621(a)(2) at the rate of 8 percent per annum for the applicable periods of underpayment, the addition to tax is determined as follows:

(A) First installment (underpayment period 4–16–09 through 12–15–09), computed as 244/365 × $17,500 × 8% = $936

(B) Second installment (underpayment period 6–16–09 through 12–15–09), computed as 183/365 × $17,500 × 8% = $702

(C) Third installment (underpayment period 9–16–09 through 12–15–09), computed as 91/365 × $17,500 × 8% = $349

(D) Fourth installment (underpayment period 12–16–09 through 3–15–10), computed as 90/365 × $7,000 × 8% = $138

(E) Total of this paragraph (j), *Example 2* (ii)(A) through (D) = $2,125

(k) *Effective/applicability date.* This section applies to taxable years beginning after September 6, 2007.

§ 1.6655–2 Annualized income installment method.

(a) *In general.* In the case of any required installment, if the corporation establishes that the annualized income installment determined under this section, or the adjusted seasonal installment determined under § 1.6655–3, is less than the amount determined under § 1.6655–1—

(1) The amount of such required installment is the annualized income installment (or, if less, the adjusted seasonal installment); and

(2) Any reduction in a required installment resulting from the application of this section will be recaptured by increasing the amount of the next required installment determined under § 1.6655–1 by the amount of such reduction (and, if the next required installment is similarly reduced, by increasing subsequent required installments to the extent that the reduction has not previously been recaptured).

(b) *Determination of annualized income installment—in general.* In the case of any required installment, the annualized income installment is the excess (if any) of—

(1) The product of the applicable percentage and the tax (after reducing the annualized tax by the amount of any allowable credits) for the taxable year

computed by annualizing the taxable income and alternative minimum taxable income—

(i) For the first 3 months of the taxable year, in the case of the first required installment;

(ii) For the first 3 months of the taxable year, in the case of the second required installment;

(iii) For the first 6 months of the taxable year, in the case of the third required installment; and

(iv) For the first 9 months of the taxable year, in the case of the fourth required installment; over

(2) The aggregate amount of any prior required installments for the taxable year.

(c) *Special rules*—(1) *Applicable percentage.* Except as otherwise provided in § 1.6655–5(d) with respect to short taxable years—

In the case of the following required installments	The applicable percentage is
1st	25
2nd	50
3rd	75
4th	100

(2) *Partial month.* Except as otherwise provided, for purposes of paragraph (b) of this section a partial month is treated as a month.

(3) *Annualization period not a short taxable year.* An annualization period is not treated as a short taxable year for purposes of determining the taxable income of an annualization period.

(d) *Election of different annualization periods.* (1) If the taxpayer timely files Form 8842, ''Election to Use Different Annualization Periods for Corporate Estimated Tax,'' in accordance with section 6655(e)(2)(C)(iii), and elects Option 1—

(i) Paragraph (b)(1)(i) of this section will be applied by using the language ''2 months'' instead of ''3 months'';

(ii) Paragraph (b)(1)(ii) of this section will be applied by using the language ''4 months'' instead of ''3 months'';

(iii) Paragraph (b)(1)(iii) of this section will be applied by using the language ''7 months'' instead of ''6 months''; and

(iv) Paragraph (b)(1)(iv) of this section will be applied by using the language ''10 months'' instead of ''9 months''.

(2) If the taxpayer timely files Form 8842, in accordance with section 6655(e)(2)(C)(iii), and elects Option 2—

(i) Paragraph (b)(1)(ii) of this section will be applied by using the language ''5 months'' instead of ''3 months'';

(ii) Paragraph (b)(1)(iii) of this section will be applied by using the language ''8 months'' instead of ''6 months''; and

(iii) Paragraph (b)(1)(iv) of this section will be applied by using the language ''11 months'' instead of ''9 months''.

(3) The application of the annualized income installment method is illustrated by the following example:

Example. (i) ABC, a calendar year corporation, had a taxable year of less than twelve months for tax year 2008 and no credits against tax for tax year 2009. ABC made an estimated tax payment of $15,000 on the installment dates of April 15, 2009, June 15, 2009, September 15, 2009, and December 15, 2009, respectively. Assume that, under paragraph (d)(1) of this section, ABC elected Option 1 by timely filing Form 8842, in accordance with section 6655(e)(2)(C)(iii), and determined that its taxable income for the first 2, 4, 7 and 10 months was $25,000, $64,000, $125,000, and $175,000 respectively. The income for each period is annualized as follows:
$25,000 × 12/2 = $150,000
$64,000 × 12/4 = $192,000
$125,000 × 12/7 = $214,286
$175,000 × 12/10 = $210,000

(ii)(A) To determine whether the installment payment made on April 15, 2009, equals or exceeds the amount that would have been required to have been paid if the estimated tax were equal to 100 percent of the tax computed on the annualized income for the 2-month period, the following computation is necessary:

(*1*) Annualized income for the 2 month period = $150,000

(*2*) Tax on this paragraph (d)(3), *Example* (ii)(A)(*1*) = $41,750

(*3*) 100% of this paragraph (d)(3), *Example* (ii)(A)(*2*) = $41,750

(*4*) 25% of this paragraph (d)(3), *Example* (ii)(A)(*3*) = $10,438

(B) Because the total amount of estimated tax that was timely paid on or before the first installment date ($15,000) exceeds the amount required to be paid on or before this date if the estimated tax were 100 percent of the tax determined by placing on an annualized basis the taxable income for the first 2-month period ($10,438), the exception described in paragraphs (a) and (b) of this section applies, and no addition to tax will be imposed for the installment due on April 15, 2009.

(iii)(A) To determine whether the installment payments made on or before June 15, 2009, equal or exceed the amount that would have been required to have been paid if the estimated tax were equal to 100 percent of the tax computed on the annualized income for the 4-month period, the following computation is necessary:

(*1*) Annualized income for the 4 month period = $192,000

(*2*) Tax on this paragraph (d)(3), *Example* (iii)(A)(*1*) = $58,130

(*3*) 100% of this paragraph (d)(3), *Example* (iii)(A)(*2*) = $58,130

(*4*) 50% of this paragraph (d)(3), *Example* (iii)(A)(*3*) less $10,438 (amount due with the first installment) = $18,627

(B) Because the total amount of estimated tax actually paid on or before the second installment date ($19,562 ($15,000 second required installment payment plus $4,562 overpayment of first required installment)) exceeds the amount required to be paid on or before this date if the estimated tax were 100 percent of the tax determined by placing on an annualized basis the taxable income for the first 4-month period ($18,627), the exception described in paragraphs (a) and (b) of this section applies, and no addition to tax will be imposed for the installment due on June 15, 2009.

(iv)(A) To determine whether the installment payments made on or before September 15, 2009, equal or exceed the amount that would have been required to have been paid if the estimated tax were equal to 100 percent of the tax computed on the annualized income for the 7-month period, the following computation is necessary:

(*1*) Annualized income for the 7 month period = $214,286

(*2*) Tax on this paragraph (d)(3), *Example* (iv)(A)(*1*) = $66,821

(*3*) 100% of this paragraph (d)(3), *Example* (iv)(A)(*2*) = $66,821

(*4*) 75% of this paragraph (d)(3), *Example* (iv)(A)(*3*) less $29,065 (amount due with the first and second installment) = $21,051

(B) Because the total amount of estimated tax actually paid on or before the third installment date ($15,935 ($15,000 third required installment payment plus $935 overpayment of second required installment)) does not equal or exceed the amount required to be paid on or before this date if the estimated tax were 100 percent of the tax determined by placing on an annualized basis the taxable income for the first 7-month period ($21,051), the exception described in paragraphs (a) and (b) of this section does not apply, and an addition to tax will be imposed with respect to the underpayment of the September 15, 2009, installment unless another exception applies to this installment payment.

(v)(A) To determine whether the installment payments made on or before December 15, 2009, equal or exceed the amount that would have been required to have been paid if the estimated tax were equal to 100 percent of the tax computed on the annualized income for the 10-month period, the following computation is necessary:

(*1*) Annualized income for the 10 month period = $210,000

(*2*) Tax on this paragraph (d)(3), *Example* (v)(A)(*1*) = $65,150

(*3*) 100% of this paragraph (d)(3), *Example* (v)(A)(*2*) = $65,150

(*4*) 100% of this paragraph (d)(3), *Example* (v)(A)(*3*) less $50,116 (amount due with the first, second and third installment) = $15,034

(B) Because the total amount of estimated tax payments made on or before the fourth installment date that is available to be applied to the estimated tax due for the fourth installment ($9,884 ($15,000 fourth required installment payment less $5,116 underpayment for the third installment of estimated tax ($21,051 third installment of estimated tax due less $15,935 payments available to be applied to the third installment of estimated tax))) does not equal or exceed the amount required to be paid on or before this date if the estimated tax were

100 percent of the tax determined by placing on an annualized basis the taxable income for the first 10-month period ($15,034), the exception described in paragraphs (a) and (b) of this section does not apply, and an addition to tax will be imposed with respect to the underpayment of the December 15, 2009, installment unless another exception applies to this installment payment.

(vi) Assuming that no other exceptions apply and the addition to tax is computed under section 6621(a)(2) at the rate of 8 percent per annum for the applicable periods of underpayment, the amount of the addition to tax is as follows:

(A) First installment (no underpayment) = $0

(B) Second installment (no underpayment) = $0

(C) Third installment (underpayment period 9–16–09 through 12–15–09), computed as $^{91}/_{365} \times \$5{,}116 \times 8\% = \$102$

(D) Fourth installment (underpayment period 12–16–09 through 3–15–10), computed as $^{90}/_{365} \times \$5{,}150 \times 8\% = \$102$

(E) Total of this paragraph (d)(3), *Example* (vi)(A) through (D) = $204

(e) *52–53 week taxable year.* (1) Generally, except as provided in the alternative rule in paragraph (e)(4) of this section, in the case of a taxpayer whose taxable year constitutes 52 or 53 weeks in accordance with section 441(f), the rules prescribed by § 1.441–2 are applicable in determining—

(i) Whether a taxable year is a taxable year of 12 months; and

(ii) When the 2-, 3-, 4-, 5-, 6-, 7-, 8-, 9-, 10-, or 11-month period (whichever is applicable) commences and ends for purposes of paragraphs (b)(1), (d)(1) and (d)(2) of this section.

(2) If a taxpayer employs four 13-week periods or thirteen 4-week accounting periods and the end of any accounting period employed by the taxpayer does not correspond to the end of the 2-, 3-, 4-, 5-, 6-, 7-, 8-, 9-, 10-, or 11-month period (whichever is applicable), then, provided the taxpayer has at least one full 4-week or 13-week accounting period, as appropriate, within the applicable period, annualized taxable income for the applicable period is—

(i) [(x/(y*13))*z], in the case of a taxpayer using four 13-week periods, if—

(A) x = Taxable income for the number of full 13-week periods in the applicable period;

(B) y = The number of full 13-week periods in the applicable period; and

(C) z = The number of weeks in the taxable year; or

(ii) [(x/(y*4))*z], in the case of a taxpayer using thirteen 4-week periods, if—

(A) x = Taxable income for the number of full 4-week periods in the applicable period;

(B) y = The number of full 4-week periods in the applicable period; and

(C) z = The number of weeks in the taxable year.

(3) If a taxpayer employs four 13-week periods and the taxpayer does not have at least one 13-week period within the applicable 2-, 3-, 4-, 5-, 6-, 7-, 8-, 9-, 10-, or 11-month period, the taxpayer is permitted to determine annualized taxable income for the applicable period based upon—

(i) The taxable income for the number of weeks in the applicable period; or

(ii) The taxable income for the full 13-week periods that end before the due date of the required installment.

(4) As an alternative to using the 52/53 week taxable year rules provided in paragraphs (e)(1), (e)(2), and (e)(3) of this section, a taxpayer whose taxable year constitutes 52 or 53 weeks in accordance with section 441(f) may base its annualization period on the month that ends closest to the end of its applicable 4-week period or 13-week period that ends within the applicable annualization period. This alternative may only be used if it is used for determining annualization periods for all required installments for the taxable year.

(5) The following examples illustrate the rules of this paragraph (e):

Example 1. Corporation ABC, an accrual method taxpayer, uses a 52/53 week year-end ending on the last Friday in December and uses four thirteen-week periods. For its year beginning December 28, 2007, ABC uses the annualized income installment method under section 6655(e)(2)(A)(i) to calculate all of its required installments. For purposes of computing its first and second required installments, the first 3 months of A's taxable year under paragraph (b)(1)(i) of this section will end on March 28th, the thirteenth Friday of ABC's taxable year. For purposes of its third required installment, the first 6 months of ABC's taxable year will end on June 27th, the twenty-sixth Friday of ABC's taxable year. For purposes of its fourth required installment, the first 9 months of ABC's taxable year will end on September 26th, the thirty-ninth Friday of ABC's taxable year.

Example 2. Same facts as *Example 1* except that ABC uses thirteen four-week periods and there are 52 weeks during ABC's taxable year beginning December 28, 2007, and ending December 26, 2008. For purposes of computing ABC's first and second required installments, ABC's annualized taxable income for the first three months will be the taxable income for the first three four-week periods of ABC's taxable year (December 28, 2007, through March 21, 2008) divided by 12 (number of full four-week periods in the first three months (3) multiplied by 4) and multiplied by 52 (the number of weeks in the taxable year). For purposes of computing ABC's third required installment, ABC's annualized taxable income for the first six months will be the taxable income for the first six four-week periods of ABC's taxable year (December 28, 2007, through June 13, 2008) divided by 24 and multiplied by 52. For purposes of computing ABC's fourth required installment, ABC's annualized taxable income for the first nine months will be the taxable income for the first nine four-week periods of ABC's taxable year (December 28, 2007, through September 5, 2008) divided by 36 and multiplied by 52.

Example 3. Same facts as *Example 1* except that ABC uses the alternative method under paragraph (e)(4) of this section for computing its required installments for 2008. For purposes of computing its first and second required installments, the first three months of ABC's taxable year under paragraph (b)(1)(i) of this section will end on March 31, 2008, the month that ends closest to the end of ABC's applicable thirteen-week period for the first and second required installments. For purposes of ABC's third required installment, the first six months of ABC's taxable year will end on June 30, 2008, the month that ends closest to the end of ABC's applicable thirteen-week period for the third required installment. For purposes of ABC's fourth required installment, the first nine months of ABC's taxable year will end on September 30, 2008, the month that ends closest to the end of ABC's applicable thirteen-week period for the fourth required installment.

(f) *Determination of taxable income for an annualization period*—(1) *In general.* This paragraph (f) applies for purposes of determining the applicability of the exception described in paragraphs (a) and (b) of this section (relating to the annualization of income) and the exception described in § 1.6655–3 (relating to annualization of income for corporations with seasonal income). An item of income, deduction, gain or loss is to be taken into account in determining the taxable income and alternative minimum taxable income (and applicable tax and alternative minimum tax) for an annualization period in the manner provided in this paragraph (f). An item may not be taken into account in determining taxable income for any annualization period unless the item is properly taken into account by the last day of that annualization period and the item is properly taken into account in determining the taxpayer's taxable income and alternative minimum taxable income (and applicable tax and alternative minimum tax) for the taxable year that includes the annualization period.

(i) *Items of income.* An item of income is taken into account in the annualization period in which the item is properly includible under the method of accounting employed by the taxpayer with respect to the item and in accordance with the appropriate provision of the Internal Revenue Code (for example, section 451 for accrual method taxpayers, section 453 for installment sales or section 460 for long-term contracts).

(ii) *Items of deduction.* An item of deduction is taken into account in the annualization period in which the item is properly deductible under the method of accounting employed by the taxpayer with respect to the item and in accordance with the appropriate provision of the Internal Revenue Code (for example, under the cash receipts and disbursements method of accounting, the deduction must be paid under § 1.461–1(a)(1) and be otherwise deductible in computing taxable income; under an accrual method of accounting, the deduction must be incurred under § 1.461–1(a)(2) and be otherwise deductible in computing taxable income). Section 170(a)(2) and § 1.170A–11(b) (charitable contributions by accrual method corporations) and § 1.461–5 (recurring item exception) may not be taken into consideration by an accrual method taxpayer in any annualization period in determining whether an item of deduction has been incurred under § 1.461–1(a)(2) during that annualization period.

(iii) *Losses.* An item of loss is to be taken into account during the annualization period in which events have occurred that permit the loss to be taken into account under the appropriate provision of the Internal Revenue Code.

(2) *Certain deductions required to be allocated in a reasonably accurate manner*—(i) *In general.* The following deductions allowed for a taxable year must be allocated throughout the taxable year in a reasonably accurate manner (as defined in paragraph (f)(2)(iii) of this section), regardless of the annualization period in which the item is paid or incurred:

(A) Real property tax deductions.

(B) Employee and independent contractor bonus compensation deductions (including the employer's share of employment taxes related to such compensation).

(C) Deductions under sections 404 (deferred compensation) and 419 (welfare benefit funds).

(D) Items allowed as a deduction for the taxable year by reason of section 170(a)(2) and § 1.170A–11(b) (certain charitable contributions by accrual method corporations), § 1.461–5 (recurring item exception) or § 1.263(a)-4(f) (12-month rule).

(E) Items of deduction designated by the Secretary by publication in the Internal Revenue Bulletin (see § 601.601(d)(2)(ii)(*b*) of this chapter).

(ii) *Application of the reasonably accurate manner requirement to certain charitable contributions, recurring items, and 12-month rule items.* For purposes of paragraph (f)(2)(i)(D) of this section, the total amount of the item deducted in the computation of taxable income for the taxable year must be allocated in a reasonably accurate manner, notwithstanding the fact that section 170(a)(2) and § 1.170A–11(b), § 1.461–5, or § 1.263(a)–4(f) applies to only a portion of the total amount of the item deducted for the taxable year. For example, if a portion of a taxpayer's rebate liabilities are deducted in the computation of taxable income under the recurring item exception, all rebate liabilities deducted in the computation of taxable income for the taxable year must be allocated in a reasonably accurate manner.

(iii) *Reasonably accurate manner defined.* (A) An item is allocated throughout the taxable year in a reasonably accurate manner if the item is allocated ratably throughout the taxable year or if the allocation provides a reasonably accurate estimate of taxable income for the taxable year based upon the facts known as of the end of the annualization period. In determining that an allocation of an item provides a reasonably accurate estimate of taxable income for the taxable year, relevant considerations include—

(*1*) The extent to which the allocation is consistent with the taxpayer's accounting for the item on its non-tax books and records;

(*2*) The extent to which the allocable portion of the item becomes fixed and determinable (under § 1.461–1(a)(2)) during the applicable annualization period; and

(*3*) The extent to which the allocation, if compared to the ratable allocation of the item, results in a better matching of the item of deduction to revenue, earnings, the use of property or the provision of services occurring during the annualization period.

(B) None of the relevant considerations above override the general requirement that the allocation must be done in a reasonably accurate manner based upon the facts known as of the end of the annualization period. For example, the fact that a liability for an annual expense becomes fixed and determinable during an annualization period will not establish that allocating all of the expense to that annualization period has been done in a reasonably accurate manner if the facts known as of the end of the annualization period indicate otherwise.

(iv) *Special rule for certain real property tax liabilities.* Notwithstanding paragraph (f)(2)(iii) of this section, real property tax liabilities for which an election under section 461(c) is in effect must be allocated ratably throughout the taxable year for purposes of this section.

(v) *Examples.* Unless otherwise stated, the following examples assume that the taxpayer uses the 3–3–6–9 annualization period:

Example 1. (i) Corporation ABC, a calendar year taxpayer, uses an accrual method of accounting and the annualized income installment method under section 6655(e)(2)(A)(i) to calculate all of its required installment payments for its 2008 taxable year. ABC has adopted a plan under which ABC pays an annual bonus to its employees. As of March 31, 2008, ABC estimates that it will pay a year-end bonus of $500,000 to its employees if earnings remain constant throughout the tax year. ABC does not pay any of the estimated bonus liability as of March 31, 2008. On October 31, 2008, ABC declares a $600,000 bonus to its employees which is paid out on November 15, 2008, and properly deducted in ABC's December 31, 2008, tax year. No other bonus liabilities are incurred by ABC during the tax year.

(ii) Under the general rule provided in paragraph (f)(2)(i) of this section, ABC is required to allocate its employee bonus liability in a reasonably accurate manner for annualization purposes. Under paragraph (f)(2)(iii) of this section, ABC's employee bonus liability will be deemed to be allocated in a reasonably accurate manner if the item is allocated ratably throughout the taxable year. Therefore, ABC is permitted to recognize a $150,000 bonus deduction (one quarter of the $600,000 bonus liability properly recognized by ABC in the tax year ending December 31, 2008) in the first annualization period ending March 31, 2008.

Example 2. (i) Corporation ABC, a calendar year taxpayer, uses an accrual method of accounting and the annualized income installment method under section 6655(e)(2)(A)(i) to calculate all of its required installment payments for its 2008 taxable year. ABC has adopted a plan under which ABC pays an annual bonus to its employees. ABC's employee bonus plan generally calls for an annual bonus equal to 2% of earnings. A bonus reserve for this amount is reported each quarter in ABC's non-tax books and records. ABC's quarterly revenues throughout the year are $10,000,000; $6,000,000; $7,000,000; and $7,000,000 respectively. As of March 31, 2008, ABC estimates that it will pay a year-end bonus of $800,000 ($10,000,000 × 4 × 2%) to its employees if earnings remain constant throughout the year. ABC does not pay any of the estimated bonus payment as of March 31, 2008. On December 31, 2008, ABC declares a $600,000 bonus to its employees which is paid out on January 15, 2009, and properly deducted in ABC's December 31, 2008, tax year.

(ii) Under the general rule provided in paragraph (f)(2)(i) of this section, ABC must allocate its employee bonus liability in a reasonably accurate manner for annualization purposes. Under paragraph (f)(2)(iii) of this section, ABC's employee bonus liability will be deemed to be allocated in a reasonably accurate manner if the allocation provides a reasonable estimate of taxable income based upon the facts known as of the end of the annualization period. Based upon its earnings activities and other information available as of March 31, 2008, ABC estimated that its total deduction for employee bonuses for the taxable year ending December 31, 2008, would be $800,000 ($10,000,000 first quarter earnings × 4 × 2%). Allocating $200,000 ($10,000,000 × 2%) of ABC's annual bonus liability of $600,000 to ABC's first quarter based upon earnings during the quarter represents a better matching of ABC's bonus expense to earnings in the quarter as compared to allocating $150,000 to ABC's first quarter under a ratable accrual method and is consistent with the allocation provided in ABC's non-tax books and records. Accordingly, allocating ABC's employee bonus deductions based upon ABC's earnings will be considered allocated in a reasonably accurate manner.

Example 3. (i) Corporation ABC, a calendar year taxpayer, uses an accrual method of accounting and the annualized income installment method under section 6655(e)(2)(A)(i) to calculate all of its required installment payments for its 2008 taxable year. ABC has adopted a plan under which ABC pays a bonus to its employees each quarter based upon earnings for that quarter. On March 31, 2008, ABC pays out $2,000,000 to its employees as a quarterly bonus based upon the earnings of ABC for the period January 1, 2008, through March 31, 2008. The $2,000,000 bonus is recognized as an expense on ABC's audited financial statements in the quarter ending March 31, 2008. As of March 31, 2008, ABC anticipates that its earnings will continue throughout the year resulting in future quarterly bonus payments in 2008 similar to the $2,000,000 first quarter payment.

(ii) Under the general rule provided in paragraph (f)(2)(i) of this section, ABC is required to allocate its employee bonus liability in a reasonably accurate manner for annualization purposes. Under paragraph (f)(2)(iii) of this section , ABC's employee bonus liability will be deemed to be allocated in a reasonably accurate manner if the item is allocated ratably throughout the taxable year. Therefore, ABC may recognize a $500,000 bonus deduction (one quarter of the $2,000,000 bonus liability properly recognized by ABC in the tax year ending December 31, 2008) in the first annualization period ending March 31, 2008 (as well as one quarter of any additional bonus liability properly recognized by ABC in the tax year ending December 31, 2008).

(iii) In addition, paragraph (f)(2)(iii) of this section provides that an allocation will be considered reasonable if the allocation provides an accurate estimate of taxable income for the taxable year based upon the facts known as of the end of the annualization period. Based upon its earnings activities and other information available as of March 31, 2008, ABC estimates that its total deduction for employee bonuses for the taxable year ending December 31, 2008, would be $8,000,000. In addition, the $2,000,000 bonus liability became fixed and determinable during the first quarter. Allocating $2,000,000 to ABC's first quarter earnings is also consistent with ABC's non-tax books and records and represents a better matching of ABC's bonus expense to earnings in the quarter as compared to a ratable accrual. Accordingly, allocating ABC's bonus liability based upon earnings will be considered a reasonably accurate manner for estimated tax purposes.

Example 4. (i) Corporation ABC, a calendar year taxpayer, uses an accrual method of accounting with the recurring item exception and the annualized income installment method under section 6655(e)(2)(A)(i) to calculate all of its required installment payments for its 2009 taxable year. ABC regularly incurs rebate obligations related to the sale of its products. Rebate coupons that are received and validated by ABC are generally paid in the following month. During the tax year ending December 31, 2009, ABC received, validated and paid $400,000 in rebates. In addition, as of the end of December 31, 2009, ABC had received and validated $100,000 in rebate claims that were paid in January of 2010 and deducted in ABC's December 31, 2009, tax year under the recurring item exception. Therefore, ABC properly recognized a $500,000 rebate liability deduction on ABC's December 31, 2009, tax return.

(ii) Under the rule provided in paragraph (f)(2)(ii) of this section, an item must be allocated in a reasonably accurate manner if any portion of the item is deducted under the recurring item exception. Therefore, ABC will be required to allocate its entire $500,000 rebate liability deduction in a reasonably accurate manner as defined in paragraph (f)(2)(iii) of this section.

(3) *Special rules*—(i) *Advance payments*—(A) *Advance payments under § 1.451–5(b)(1)(ii).* An advance payment for which the taxpayer uses the method of accounting provided in § 1.451–5(b)(1)(ii) is includible in computing taxable income for an annualization period in accordance with that method of accounting except that, if § 1.451–5(c) applies, any amount not included in computing taxable income by the end of the second taxable year following the year in which substantial advance payments are received, and not previously included in accordance with the taxpayer's accrual method of accounting, is includible in computing taxable income on the last day of such second taxable year.

(B) *Advance payments under Rev. Proc. 2004–34.* An advance payment for which the taxpayer uses the Deferral Method provided in section 5.02 of Rev. Proc. 2004–34 (2004–1 CB 991), (see § 601.601(d)(2)(ii)(*b*) of this chapter) is includible in computing taxable income for an annualization period in accordance with that method of accounting, except that any amount not included in computing taxable income by the end of the taxable year succeeding the taxable year of receipt is includible in computing taxable income on the last day of such succeeding taxable year.

(ii) *Extraordinary items*—(A) *In general.* In general, extraordinary items must be taken into account after annualizing the taxable income for the annualization period. For purposes of the preceding sentence an extraordinary item is any item identified in § 1.1502–76(b)(2)(ii)(C)(1), (2), (3), (4), (7), and (8), a net operating loss carryover, a section 481(a) adjustment, net gain or loss from the disposition of 25 percent or more of the fair market value of a taxpayer's business assets during a taxable year, and any other item designated by the Secretary by publication in the Internal Revenue Bulletin (see § 601.601(d)(2)(ii)(b) of this chapter).

(B) *De minimis extraordinary items.* A taxpayer may treat any *de minimis* extraordinary item, other than a net operating loss carryover or section 481(a) adjustment, as an item under the general rule of paragraph (f)(1) of this section rather than an extraordinary item as provided for in paragraph (f)(3)(ii) of this section. A *de minimis* extraordinary item is any item identified in paragraph (f)(3)(ii)(A) of this section resulting from a transaction in which the total extraordinary items resulting from such transaction is less than $1,000,000.

(C) *Special rule for net operating loss deductions and section 481(a) adjustments.* For purposes of paragraph (f)(3)(ii) of this section, a taxpayer must treat a net operating loss deduction and section 481(a) adjustment as extraordinary items arising on the first day of the tax year in which the item is taken into account in determining taxable income. Notwithstanding the preceding sentence, a taxpayer may choose to treat the portion of a section 481(a) adjustment recognized during the tax year of the accounting method change as an extraordinary item arising on the date the Form 3115, ''Application for Change in Accounting Method,'' requesting the change was filed with the national office of the Internal Revenue Service.

(iii) *Credits*—(A) *Current year credits.* With respect to a current year credit, the items upon which the credit is computed are annualized, the amount of the credit is computed based on the annualized items, and the amount of the credit is deducted from the annualized tax. For example, for an annualization period consisting of three months in a full 12-month taxable year, the items upon which the credit is based that are taken into account for the three month period are multiplied by four, the credit is determined based on the annualized amount of the items, and the credit reduces the annualized tax.

(B) *Credit carryovers.* Any credit carryover to the current taxable year is taken into account in computing an annualized income installment only after annualizing the taxable income for the annualization period and computing the applicable tax, and before applying the applicable percentage.

(iv) *Depreciation and amortization*—(A) *Estimated annual depreciation and amortization.* In general, in determining taxable income for any annualization period, a proportionate amount of the taxpayer's estimated annual depreciation and amortization (depreciation) expense may be taken into account. For purposes of the preceding sentence, estimated annual depreciation expense is the estimated depreciation expense to be properly taken into account in determining the taxpayer's taxable income for the taxable year. In determining the estimated annual depreciation expense, a taxpayer may take into account purchases, sales or other dispositions, changes in use, additional first-year depreciation and expense deductions and section 179 or any similar provision, and other events that, based on all the relevant information available as of the last day of the annualization period (such as capital spending budgets, financial statement data and projections, or similar reports that provide evidence of the taxpayer's capital spending plans for the current taxable year), are reasonably expected to occur or apply during the taxable year.

(B) *Safe harbors*—(*1*) *Proportionate depreciation allowance.* In determining taxable income for any annualization period, in lieu of the rule provided in paragraph (f)(3)(iv)(A) of this section a taxpayer may take into account a proportionate amount of the depreciation and amortization (depreciation) expense, including special depreciation and expense deductions such as those provided for in section 168(k) and section 179 or any similar provision, allowed for the taxable year from—

(*i*) Assets that were in service on the last day of the prior taxable year, are in service on the first day of the current taxable year, and that have not been disposed of during the annualization period;

(*ii*) Assets placed in service during the annualization period and have not been disposed of during that period; and

(*iii*) Assets that were in service on the last day of the prior taxable year and that are disposed of during the annualization period.

(*2*) *90 percent of preceding year's depreciation.* In determining taxable income for any annualization period, in lieu of the general rule provided in paragraph (f)(3)(iv)(A) of this section, a proportionate amount of 90 percent of the amount of depreciation and amortization (depreciation) expense taken on the taxpayer's Federal income tax return for the preceding taxable year may be taken into account. If the taxpayer's preceding taxable year is less than 12 months (a short taxable year), the amount of depreciation expense taken into account is annualized by multiplying the depreciation and amortization for the short taxable year by 12, and dividing the result by the number of months in the short taxable year.

(*3*) *Safe harbor operational rules.* If a taxpayer selects one of the two safe harbors provided in paragraph (f)(3)(iv)(B)(*1*) or paragraph (f)(3)(iv)(B)(*2*) of this section, the taxpayer must use that safe harbor for all depreciation expenses within the annualization period for the annualized income installment. However, a taxpayer may use either the method provided for in paragraph (f)(3)(iv)(A) of this section or a method provided for in this paragraph (f)(3)(iv)(B) of this section for each annualized income installment during the taxable year. For example, a taxpayer may use the safe harbor provided in paragraph (f)(3)(iv)(B)(*1*) of this section for its first annualized income installment and may use the general rule provided in paragraph (f)(3)(iv)(A) of this section for its second annualized income installment.

(C) *Short taxable years.* If the taxable year is, or will be, a short taxable year (based on all relevant information available as of the last day of the annualization period), annual depreciation expense is computed using the rules applicable for computing depreciation during a short taxable year for purposes of determining the annual depreciation expense to be allocated to an annualization period. For this purpose, the rules applicable for computing depreciation during a short taxable year are applied on the basis of the date the taxable year is expected to end based on all relevant information available as of the last day of the annualization period. See Rev. Proc. 89–15 (1989–1 CB 816) for computing depreciation expense under section 168 (see § 601.601(d)(2)(ii)(*b*) of this chapter). An annualization period is not treated as a short taxable year for purposes of determining the depreciation expense for an annualization period. See paragraph (c)(3) of this section.

(v) *Distributive share of items*—(A) *Member of partnership.* In determining a partner's distributive share of partnership items that must be taken into account during an annualization period, the rules set forth in § 1.6654–2(d)(2) are applicable.

(B) *Treatment of subpart F income and income under section 936(h)*—(*1*) *General rule.* Any amounts required to be included in gross income under section 936(h) or section 951(a), and credits properly allocable thereto, are taken into account in computing any annualized income installment in a manner similar to the manner under which partnership inclusions, and credits properly allocable thereto, are taken into account in accordance with paragraph (f)(3)(v)(A) of this section.

(*2*) *Prior year safe harbor*—(i) *General rule.* If a taxpayer elects to have the safe harbor in this paragraph (f)(3)(v)(B)(2) apply for any taxable year, then paragraph (f)(3)(v)(B)(*1*) of this section does not apply; and, for purposes of computing any annualized income installment for the taxable year, the taxpayer is treated as having received ratably during the taxable year items of income and credit described in paragraph (f)(3)(v)(B)(*1*) of this section in an amount equal to 115 percent of the amount of such items shown on the return of the taxpayer for the preceding taxable year (the second preceding taxable year in the case of the first and second required installments for such taxable year).

(ii) *Special rule for noncontrolling shareholder.* If a taxpayer making the election under paragraph (f)(3)(v)(B)(*2*)(*i*) of this section is a noncontrolling shareholder of a corporation, paragraph (f)(3)(v)(B)(*2*)(*i*) of this section is applied with respect to items of such corporation by substituting ''100 percent'' for ''115 percent''. For purposes of paragraph (f)(3)(v)(B)(*2*)(*ii*) of this section, the term *noncontrolling shareholder* means, with respect to any corporation, a shareholder that, as of the beginning of the taxable year for which the installment is being made, does not own within the meaning of section 958(a), and is not treated as owning within the meaning of section 958(b), more than 50 percent by vote or value of the stock in the corporation.

(C) *Dividends from closely held real estate investment trust*—(*1*) *General rule.* Any dividend received from a closely held real estate investment trust by any person that owns, after the application of section 856(d)(5), 10 percent or more by vote or value of the stock or beneficial interests in the trust is taken into account in computing annualized income installments in a manner similar to the manner under which partnership income inclusions are taken into account.

(*2*) *Closely held real estate investment trust.* For purposes of paragraph (f)(3)(v)(C)(*1*) of this section, the term *closely held real estate investment trust* means a real estate investment trust with respect to which 5 or fewer persons own, after the application of section 856(d)(5), 50 percent or more by vote or value of the stock or beneficial interests in the trust.

(D) *Other passthrough entities.* A taxpayer's distributive share of items from a passthrough entity, other than those described in paragraphs (f)(3)(v)(A) and (f)(3)(v)(C) of this section, is taken into account in computing any annualized income installment in a manner similar to the manner under which partnership items are taken into account under paragraph (f)(3)(v)(A) of this section.

(vi) *Alternative minimum taxable income exemption amount.* The alternative minimum taxable income exemption amount provided by section 55(d)(2) is applied after the alternative minimum taxable income for the annualization period is annualized.

(vii) *Examples.* The provisions of this paragraph (f) are illustrated by the following examples. Unless otherwise stated, the following examples assume that the taxpayer uses the 3–3–6–9 annualization period.

Example 1. Expense paid or incurred in the installment period. Corporation ABC, a calendar year taxpayer, uses an accrual method of accounting and the annualized income installment method under section 6655(e)(2)(A)(i) to calculate all of its required installment payments for its 2008 taxable year. ABC has licensed technology from Corporation XYZ. Pursuant to the license agreement, ABC pays a license fee to XYZ equal to $.01 for every dollar of gross receipts earned by ABC. For 2008, ABC projects gross receipts of $200,000,000, of which $100,000,000 is earned by March 31, 2008. Pursuant to paragraph (f)(1) of this section, a license fee expense of $1,000,000 ($100,000,000 × $.01) is incurred by March 31, 2008, and may be taken into account for purposes of determining the taxable income to be annualized in computing ABC's first annualized income installment.

Example 2. Expense not paid or incurred in the installment period. Same facts as *Example 1* except that ABC does not earn any gross receipts by March 31, 2008. In accordance with paragraph (f)(1) of this section, because the license fee expense was not incurred under § 1.461–1(a)(2) by the last day of the annualization period, no license fee expense is taken into account for purposes of determining the taxable income to be annualized in computing ABC's first annualized income installment, which is based on the income and deductions from the first three months of the taxable year.

Example 3. Bad debt expense. Corporation ABC, a calendar year taxpayer, uses an accrual method of accounting and the annualized income installment method under section 6655(e)(2)(A)(i) to calculate all of its required installment payments for its 2008 taxable year. As of December 31, 2007, ABC had a $100,000 account receivable due from XYZ related to the sale of goods from ABC to XYZ during 2007. On March 30, 2008, ABC determined that its receivable from XYZ was worthless under section 166 and the regulations. No other receivables were determined to be worthless between January 1, 2008, and March 31, 2008. In accordance with paragraph (f)(1) of this section, a $100,000 bad debt write-off is taken into account for purposes of determining the taxable income to be annualized in computing ABC's first annualized income installment.

Example 4. Bad debt expense. Same facts as *Example 3* except that ABC determines that the receivable from XYZ was worthless under section 166 and the regulations on April 10, 2008. As of March 31, 2008, ABC had not determined that any receivables were worthless under section 166 and the regulations. In accordance with paragraph (f)(1) of this section, the $100,000 bad debt expense attributable to the receivable from XYZ is not taken into account for purposes of determining the taxable income to be annualized in computing ABC's first annualized income installment, which is based on the income and deductions from the first three months of the taxable year, because the receivable from XYZ became worthless after the last day of the annualization period.

Example 5. Employer deductions under section 404 and 419. (i) Corporation ABC, a calendar year taxpayer, uses an accrual method of accounting and uses the annualized income installment method under section 6655(e)(2)(A)(i) to calculate all of its required installment payments for its 2008 taxable year. On March 1, 2008, the board of directors of ABC makes a binding, irrevocable commitment to fund a minimum contribution of $10,000,000 to ABC's qualified retirement plan by March 14, 2009. ABC remits a $1,000,000 payment to the retirement plan on March 1, 2008, and a $9,000,000 payment on March 3, 2009. ABC does not incur any other related retirement plan deductions during its 2008 taxable year.

(ii) Under the rule provided in paragraph (f)(2)(i) of this section, ABC's employer deduction for payment made to the qualified plan must be allocated throughout the tax year for estimated tax purposes in a reasonably accurate manner. Therefore, ABC will not be permitted to allocate the $10,000,000 deduction to its first installment period. Under paragraph (f)(2)(iii) of this section, ABC's qualified plan deduction will be deemed to be allocated in a reasonably accurate manner if the item is allocated ratably throughout the taxable year. Therefore, ABC will be permitted to allocate $2,500,000 of its qualified plan deduction in its first installment period.

Example 6. Prepaid expense. (i) Corporation ABC, a calendar year taxpayer, uses an accrual method of accounting and does not capitalize qualifying costs under the exception provided for in § 1.263(a)–4(f). ABC uses the annualized income installment method under section 6655(e)(2)(A)(i) to calculate all of its required installment payments for its 2008 taxable year. On July 1, 2008, ABC purchases an annual business license from State X which permits ABC to operate its business in State X from July 1, 2008, through June 30, 2009. An annual payment of $12,000 is due on July 1, 2008, and ABC pays the fee on this date. ABC has not elected out of the 12-month rule provided by § 1.263(a)–4(f) and therefore ABC is not required to capitalize any amount paid for the license and will recognize a $12,000 deduction for the tax year ending December 31, 2008, with respect to this license.

(ii) Under the rule provided in paragraph (f)(2)(ii) of this section, ABC's $12,000 business license expense must be allocated in a reasonably accurate manner because ABC utilizes the 12-month rule exception provided for in the § 1.263(a)–4(f). Under paragraph (f)(2)(iii) of this section, ABC's deduction will be deemed to be allocated in a reasonably accurate manner if the item is allocated ratably throughout the taxable year. Therefore, ABC will be permitted to allocate $3,000 of its business license deduction in its first installment period.

Example 7. Real property tax liability. (i) Corporation ABC, a calendar year taxpayer, uses an accrual method of accounting and the annualized income installment method under section 6655(e)(2)(A)(i) to calculate all of its required installment payments for its 2008 taxable year. ABC owns real property in State Y and uses the real property in its trade or business. ABC incurs a $400,000 deduction for State Y real estate taxes during ABC's December 31, 2008, taxable year. ABC has elected to recognize its real property taxes ratably under section 461(c).

(ii) Under the rule provided in paragraph (f)(2)(i) of this section, ABC's $400,000 real property tax liabilities must be allocated in a reasonably accurate manner. However, paragraph (f)(2)(iv) of this section provides that with respect to real property taxes for which an election has been made under section 461(c), ratable accrual is the only method which will be considered a reasonably accurate method. Therefore, ABC will be required to allocate its $400,000 real property taxes ratably for estimated tax purposes and thus $100,000 will be allocated to the ABC's first annualized income installment.

Example 8. NOL (Net Operating Loss) deduction. Corporation ABC, a calendar year taxpayer, uses an accrual method of accounting and the annualized income installment method under section 6655(e)(2)(A)(i) to calculate all of its required installment payments for its 2008 taxable year. ABC has a net operating loss carryover to 2008 of $2,000,000. ABC's taxable income from January 1, 2008, through March 31, 2008, without regard to any net operating loss deduction, is $1,500,000 (pre-NOL taxable income). Under the special rule for net operating loss deductions provided in paragraph (f)(3)(ii) of this section, the NOL deduction is treated as an extraordinary item incurred on the first day of ABC's December 31, 2008, tax year. Therefore, the NOL deduction is taken into account after annualization for purposes of determining ABC's first annualized income installment.

Example 9. Advance payment. (i) Corporation ABC, a calendar year taxpayer, uses an accrual method of accounting and the annualized income installment method under section 6655(e)(2)(A)(i) to calculate all of its required installment payments for its 2008 and 2009 taxable years. ABC is in the business of giving dancing lessons and receives advance payments. For Federal income tax purposes, ABC uses the Deferral Method provided in section 5.02 of Rev. Proc. 2004–34 for the advance payments it receives for dance lessons. On November 1, 2008, ABC receives an advance payment of $2,400 for a 2-year contract commencing on November 1, 2008, and providing for up to 24 individual, 1-hour lessons. ABC provides 2 lessons in 2008, 12 lessons in 2009, and 10 lessons in 2010. ABC recognizes $200 in revenues in its financial statements for the last quarter of 2008. ABC recognizes $300 in revenues in its financial statements for each quarter of 2009 for a total of $1,200 in 2009. ABC recognizes the remaining $1,000 in revenues in its financial statements during 2010. For tax purposes, ABC recognizes $200 into revenue in 2008 and $2,200 into revenue in 2009 under Rev. Proc. 2004–34. See § 601.601(d)(2)(ii)(*b*).

(ii) Pursuant to paragraph (f)(3)(i)(B) of this section, ABC is not required to take into account any of the advance payment for purposes of computing any required installment payment for ABC's 2008 taxable year because no part of the $2,400 advance payment was recognized as income in ABC's financial statements during the first nine months of ABC's 2008 taxable year. In 2009, ABC must take into account $300 of revenue for purposes of computing its first and second required installment payments, $600 of revenue for purposes of computing its third required installment payment and $900 for purposes of computing its fourth required installment payment. Pursuant to paragraph (f)(3)(i)(B) of this section, the remaining deferred revenue is recognized on December 31, 2009, for purposes of computing ABC's annualized income installments for 2009.

Example 10. Section 481(a) adjustment. Corporation ABC, a calendar year taxpayer, uses an accrual method of accounting and the annualized income installment method under section 6655(e)(2)(A)(i) to calculate all of its required installment payments for its 2008 taxable year. On December 20, 2008, ABC files a Form 3115 requesting permission to change its method of accounting. The requested change results in a negative section 481(a) adjustment of $80,000. ABC subsequently receives the consent of the Commissioner to make the change and therefore, the negative $80,000 section 481(a) adjustment is properly recognized in ABC's tax return for the year ending December 31, 2008. Under paragraph (f)(3)(ii) of this section ABC is permitted to recognize the negative $80,000 section 481(a) adjustment as an extraordinary item occurring on January 1, 2008 (the first day of ABC's December 31, 2008, tax year), or December 20, 2008 (the date ABC filed the Form 3115). ABC chooses to recognize the negative $80,000 section 481(a) adjustment as an extraordinary item occurring in January 1, 2008. Accordingly, $80,000 of the negative section 481(a) adjustment is taken into account after annualization for purposes of determining ABC's first annualized income installment. In addition, under § 1.6655–6(b), ABC is required to use its new method of accounting as of January 1, 2008 for estimated tax purposes, consistent with the recognition of the section 481(a) adjustment for estimated tax purposes. Therefore, ABC will be required to use the new method of accounting in determining taxable income to be annualized in computing ABC's first annualized income installment.

Example 11. Section 481(a) adjustment. Corporation ABC, a calendar year taxpayer, uses an accrual method of accounting and uses the annualized income installment method under section 6655(e)(2)(A)(i) to calculate all of its required installment payments for its 2008 taxable year. On June 15, 2008, ABC files a Form 3115 requesting permission to change its method of accounting. The requested change results in a positive section 481(a) adjustment of $240,000. ABC subsequently receives the consent of the Commissioner to make the change and therefore, $60,000 of the section 481(a) adjustment (one quarter of the positive $240,000 section 481(a) adjustment) is properly recognized in ABC's tax return for the year ending December 31, 2008. Under paragraph (f)(3)(ii) of this section, ABC is permitted to recognize the positive $60,000 section 481(a) adjustment as an extraordinary item occurring on January 1, 2008 (the first day of ABC's December 31, 2008, tax year), or June 15, 2008 (the date ABC filed the Form 3115). ABC chooses to recognize the positive $60,000 section 481(a) adjustment as an extraordinary item occurring on June 15, 2008. Accordingly, the $60,000 positive section 481(a) adjustment is not taken into account for purposes of determining ABC's first annualized income installment. However, in all futures years any portion of the section 481(a) adjustment related to this change in method of accounting will be treated as an extraordinary item occurring on the first day of the tax year under paragraph (f)(3)(ii) of this section. In addition, under § 1.6655–6(b), ABC is required to use its new method of accounting as of June 15, 2008 for estimated tax purposes, consistent with the recognition of the section 481(a) adjustment for estimated tax purposes. Therefore, ABC will be required to use the new method of accounting (as of the beginning of the tax year) for purposes of determining taxable income to be annualized in computing ABC's third and fourth annualized income installments (which are based upon annualization periods that include June 15, 2008.)

Example 12. Extraordinary item. Corporation ABC, a calendar year taxpayer, uses an accrual method of accounting and the annualized income installment method under section 6655(e)(2)(A)(i) to calculate all of its required installment payments for its 2008 taxable year. On May 10, 2008, ABC reaches a settlement agreement with XYZ over a tort action filed by ABC. As a result, ABC receives a payment of $10,000,000 on June 15, 2006, that is recognized as income by ABC. The settlement of a tort action is an extraordinary item defined in paragraph (f)(3)(ii)(A) of this section. Accordingly, the $10,000,000 of income will be taken into account by ABC on May 10, 2008, for purposes of computing ABC's annualized income installments for 2008. Therefore, the $10,000,000 settlement will only be taken into account in computing ABC's third and fourth annualized income installments (which are based upon annualization periods that include May 10, 2008). In addition, the $10,000,000 settlement income will be taken into account as an extraordinary item of income after annualization for purposes of determining ABC's third and fourth annualized installment payments.

Example 13. Credit carryover. Corporation ABC, a calendar year taxpayer, uses an accrual method of accounting and the annualized income installment method under section 6655(e)(2)(A)(i) to calculate all of its required installment payments for its 2008 taxable year. ABC projects its annualized tax for its 2008 taxable year, based on annualizing ABC's taxable income for its first annualization period from January 1, 2008, through March 31, 2008, to be $1,500,000 before reduction for any credits. ABC has an unused section 38 credit from 2007 for increasing research activities from 2007 of $500,000 that is carried over to 2008. For purposes of determining ABC's first annualized income installment, ABC's annualized tax for 2008 is $1,000,000, determined as the tax for the taxable year computed by placing on an annualized basis ABC's taxable income from its first annualization period from January 1, 2008, through March 31, 2008 ($1,500,000) reduced by the $500,000 credit carryover from 2007. Therefore, ABC's first required installment payment for 2008 is $250,000 ($1,000,000 × 25%).

Example 14. Current year credit. Corporation ABC, a calendar year taxpayer, uses an accrual method of accounting and the annualized income installment method under section 6655(e)(2)(A)(i) to calculate all of its required installment payments for its 2008 taxable year. ABC projects its annualized tax for its 2008 taxable year, based on annualizing ABC's taxable income for its first annualization period from January 1, 2008, through March 31, 2008, to be $2,000,000 before reduction for any credits. ABC has historically earned a section 41 credit for increasing research activities and, for 2008, ABC estimates that it will earn a credit for increasing research activities under section 41 of $1,200,000. However, pursuant to paragraph (f)(3)(iii) of this section, if ABC were to annualize all components involved in computing the current year credit based on ABC's activity from January 1, 2008, through March 31, 2008, ABC would generate a credit of $1,600,000 for 2008. For purposes of determining ABC's first annualized income installment, ABC's annualized tax for 2008 is $400,000, determined as the tax for the 2008 taxable year ($2,000,000) computed by placing on an annualized basis ABC's taxable income from its first annualization period January 1, 2008, through March 31, 2008, reduced by a $1,600,000 current year section

41 credit from increasing research activities. Therefore, ABC's first required installment payment for 2008 is $100,000 ($400,000 × 25%).

Example 15. Current year credit. Same facts as *Example 14* except that ABC does not begin any research activities until April 3, 2008, and will not incur any research expenses described in paragraph (f)(1)(ii) of this section. As a result, if ABC were to annualize all components involved in computing the current year credit based on ABC's activity from January 1, 2008, through March 31, 2008, ABC would generate no section 41 research credit for purposes of determining its first annualized income installment. Pursuant to paragraph (f)(3)(iii) of this section, ABC cannot take into account any credit for its first annualization period because ABC did not incur any qualified research expenses by the last day of the first annualization period. Accordingly, for purposes of determining ABC's first annualized income installment, ABC's annualized tax for its first annualization period January 1, 2008, through March 31, 2008, is $2,000,000. Therefore, ABC's first required installment payment for 2008 is $500,000 ($2,000,000 × 25%).

Example 16. Depreciation and amortization expense. Corporation ABC, a calendar year taxpayer that began business on January 2, 2007, adopted an accrual method of accounting and will use the annualized income installment method under section 6655(e)(2)(A)(i) to calculate all of its required installment payments for its 2008 taxable year. On January 2, 2007, ABC purchased and placed in service a tangible depreciable asset that costs $50,000 and is 5-year property under section 168(e). ABC depreciates its 5-year property placed in service in 2007 under the general depreciation system using the 200-percent declining balance method, a 5-year recovery period, and the half year convention. On January 2, 2008, ABC purchased and placed in service qualified Gulf Opportunity Zone property (GO Zone property) that costs $30,000 and is 5-year property under section 168(e). ABC will depreciate its 5-year property placed in service in 2008 under the general depreciation system using the 200-percent declining balance method, a 5-year recovery period, and the half-year convention. ABC will deduct the 50% additional first year depreciation deduction under section 1400N(d) with respect to the GO Zone property. For tax year 2007, ABC takes a depreciation deduction under section 168 of $10,000 ($50,000 × 20% = $10,000). ABC does not anticipate being subject to the mid-quarter convention for the 2008 taxable year, does not anticipate making any depreciation elections for any class of property, does not anticipate making a section 179 election, does not anticipate any sales or other dispositions of depreciable property, and no events have occurred, nor does ABC know, based on all relevant information available as of the due date of ABC's first required installment for 2008, of any event that will occur to cause ABC's 2008 taxable year to be a short taxable year. The optional amounts of depreciation expense ABC may take into account for its first annualized income installment for its 2008 taxable year are determined as follows:

(i) *General rule—Estimated annual depreciation.* In accordance with the general rule provided in paragraph (f)(3)(iv)(A) of this section, ABC may take a depreciation expense of $8,500 ($34,000 × 3⁄12 = $8,500) into account in computing ABC's January 1, 2008, through March 31, 2008, taxable income. ABC's estimated annual depreciation expense for 2008 of $34,000 is computed as follows: $15,000 for the 50% additional first year depreciation deduction under section 1400N(d) ($30,000 × 50% = $15,000) plus annual depreciation of $16,000 ($40,000 × 40% = $16,000) and $3,000 ($15,000 × 20% = $3,000). Under paragraphs (c)(3) and (f)(3)(iv)(C) of this section, ABC may not consider its first annualization period to be a short taxable year for purposes of determining the depreciation allowance for such annualization period.

(ii) *Safe Harbor—Proportionate depreciation allowance.* In accordance with the safe harbor provided in paragraph (f)(3)(iv)(B)(1) of this section, ABC may take a depreciation expense of $8,500 ($34,000 × 3⁄12 = $8,500) into account in computing ABC's January 1, 2008, through March 31, 2008, taxable income based on annual depreciation expense for 2008 of $34,000, computed as follows: $15,000 for the 50% additional first year depreciation deduction under section 1400N(d) ($30,000 × 50% = $15,000) plus annual depreciation of $16,000 ($40,000 × 40% = $16,000) and $3,000 ($15,000 × 20% = $3,000). Under paragraphs (c)(3) and (f)(3)(iv)(C) of this section, ABC may not consider its first annualization period to be a short taxable year for purposes of determining the depreciation allowance for such annualization period.

(iii) *Safe Harbor—90 percent of preceding year's depreciation.* In accordance with the safe harbor in paragraph (f)(3)(iv)(B)(*2*) of this section, ABC may take a depreciation expense of $2,250 ($10,000 prior year's depreciation × 90% = $9,000 × 3⁄12 = $2,250) into account in computing ABC's January 1, 2008, through March 31, 2008, taxable income. Under paragraphs (c)(3) and (f)(3)(iv)(C) of this section, ABC may not consider its first annualization period to be a short taxable year for purposes of determining the depreciation allowance for such annualization period.

(g) *Items that substantially affect taxable income but cannot be determined accurately by the installment due date*—(1) *In general.* In determining the applicability of the annualization exceptions described in paragraphs (a) and (b) of this section and § 1.6655–3, reasonable estimates may be made from existing data for items that substantially affect income if the amount of such items cannot be determined accurately by the installment due date. This paragraph (g) applies only to the inflation index for taxpayers using the dollar-value LIFO (last-in, first-out) inventory method, adjustments required under section 263A, the computation of a taxpayer's section 199 deduction, intercompany adjustments for taxpayers that file consolidated returns, the liquidation of a LIFO layer at the installment date that the taxpayer reasonably believes will be replaced at the end of the year, deferred gain on a qualifying conversion or exchange of property under sections 1031 and 1033 that the taxpayer reasonably believes will be replaced with qualifying replacement property, and any other item designated by the Secretary by publication in the Internal Revenue Bulletin (see § 601.601(d)(2)(ii)(*b*) of this chapter).

(2) *Example.* The following example illustrates the rules of this paragraph (g):

Example. Section 199 deduction. Corporation ABC, a calendar year taxpayer, uses an accrual method of accounting and the annualized income installment method under section 6655(e)(2)(A)(i) to calculate all of its required installment payments for its 2008 taxable year. ABC engages in production activities that generate qualified production activities income (QPAI), as defined in § 1.199–1(c), and projects taxable income of $50,000 for its first annualization period from January 1, 2008, through March 31, 2008, without taking into account the section 199 deduction. During its first annualization period from January 1, 2008, through March 31, 2008, ABC incurs W–2 wages allocable to domestic production gross receipts pursuant to section 199(b)(2) of $10,000. Pursuant to paragraph (g)(1) of this section, ABC is permitted to take into account its estimated section 199 deduction before annualizing taxable income based on the lesser of its estimated QPAI or taxable income and W–2 wages for its first installment period for 2008. For the first installment period in 2008, ABC's is permitted to recognize a deduction under section 199 of $3,000 ($50,000 × .06 = $3,000) subject to the wage limitation of $5,000 (50 percent of $10,000 of W–2 wages incurred during the first installment period). Accordingly, ABC's annualized income for the first installment for 2008 is $188,000 (($50,000–$3,000) × 1 2⁄3 = $188,000). The tax on $188,000 is $56,570 and ABC's first required installment for 2008 is $14,143 ($56,570 × .25 = $14,143).

(h) *Effective/applicability date.* This section applies to taxable years beginning after September 6, 2007.

■ **Par. 8A.** Section 1.6655–3 is revised to read as follows:

§ 1.6655–3 Adjusted seasonal installment method.

(a) *In general.* In the case of any required installment, the amount of the adjusted seasonal installment is the excess (if any) of—

(1) 100 percent of the amount determined under paragraph (c) of this section; over

(2) The aggregate amount of all prior required installments for the taxable year.

(b) *Limitation on application of section.* This section applies only if the base period percentage (as defined in section 6655(e)(3)(D)(i) and paragraph (d)(1) of this section) for any six consecutive months of the taxable year equals or exceeds seventy percent.

(c) *Determination of amount.* The amount determined under this paragraph (c) for any installment will be determined in the following manner—

(1) Take the taxable income for all months during the taxable year preceding the filing month;

(2) Divide such amount by the base period percentage for all months during the taxable year preceding the filing month;

(3) Determine the tax on the amount determined under paragraph (c)(2) of this section; and

(4) Multiply the tax computed under paragraph (c)(3) of this section by the base period percentage for the filing month and all months during the taxable year preceding the filing month.

(d) *Special rules*—(1) *Base period percentage.* The base period percentage for any period of months is the average percent that the taxable income for the corresponding months in each of the three preceding taxable years bears to the taxable income for the three preceding taxable years. If there is no taxable income for the corresponding months, taxable income for this purpose is zero.

(2) *Filing month.* The term *filing month* means the month in which the installment is required to be paid.

(3) *Application of the rules related to the annualized income installment method to the adjusted seasonal installment method.* The rules governing the computation of taxable income (and resulting tax) for purposes of determining any required installment payment of estimated tax under the annualized income installment method under § 1.6655–2 apply to the computation of taxable income (and resulting tax) for purposes of determining any required installment payment of estimated tax under the adjusted seasonal installment method.

(4) *Alternative minimum tax.* The amount determined under paragraph (c) of this section must properly take into account the amount of any alternative minimum tax under section 55 that would apply for the period of the computation. The amount of any alternative minimum tax that would apply is determined by applying to alternative minimum taxable income, tentative minimum tax, and alternative minimum tax, the rules described in paragraph (c) of this section for taxable income and tax.

(e) *Example.* The provisions of this section may be illustrated by the following example:

Example. (i) X, a corporation that reports on a calendar year basis, expects to have an estimated tax liability of $1,200,000 for its taxable year ending December 31, 2009. On its 2008 tax return, X reports a tax liability of $652,800. X pays four installments of estimated tax, each in the amount of $250,000, $250,000, $250,000, and $450,000 on April 15, 2009, June 15, 2009, September 15, 2009, and December 15, 2009, respectively. X reports a tax liability of $1,152,600 on its return due March 15, 2010, with no credits against tax. Under the general provision of section 6655(b) and section 6655(d), there was an underpayment in the amount of $76,300 for the second installment through September 15, 2009, and $114,450 for the third installment through December 15, 2009, determined as follows:

(A) Tax as defined in section 6655(g) = $1,152,600

(B) 100% of this paragraph (e), Example (i)(A) = $1,152,600

(C) Amount of estimated tax required to be paid on or before the first installment (25% of $652,800) = $163,200

(D) Deduction of amount timely paid on or before the first installment due date under the general rule of section 6655(b) = $250,000

(E) Amount of overpaid estimated tax for the first installment date = $86,800

(F) Amount of estimated tax required to be paid on or before the second installment (25% of $1,152,600 plus the recapture amount under section 6655(d)(2)(B) of $124,950 (25% of $1,152,600 less $163,200)) = $413,100

(G) Deduction of amount paid on or before the due date of the second installment less amount applied towards the first installment under the general rule of section 6655(b) ($250,000 paid in each of the first and second installments less this paragraph (e), Example (i)(C)) = $336,800

(H) Amount of underpayment for the second installment date = $76,300

(I) Amount of estimated tax required to be paid on or before the third installment (25% of $1,152,600) = $288,150

(J) Deduction of amount paid on or before the due date of the third installment less amount applied towards the first and second installments under the general rule of section 6655(b) ($250,000 paid in each of the first, second, and third installments less this paragraph (e), *Example* (i)(C) less this paragraph (e), *Example* (i)(F)) = $173,700

(K) Amount of underpayment for the third installment date = $114,450

(L) Amount of estimated tax required to be paid on or before the fourth installment (25% of $1,152,600) = $288,150

(M) Deduction of amount paid on or before the due date of the fourth installment less amount applied towards the first, second, and third installments under the general rule of section 6655(b) ($250,000 paid in each of the first, second, and third installments plus $450,000 paid in the fourth installment less this paragraph (e), *Example* (i)(C) less this paragraph (e), *Example* (i)(F) less this paragraph (e), *Example* (i)(I)) = $335,550

(N) Amount of overpaid estimated tax for the fourth installment date = $47,400

(ii) X wants to determine if it qualifies for the adjusted seasonal installment method. X determines that its monthly taxable income for the preceding three taxable years and for the current taxable year 2009 is as follows:

January	February	March	April	May	June	July	August	September	October	November	December
2006: $100,000	$90,000	$80,000	$70,000	$60,000	$20,000	$10,000	$10,000	$10,000	$10,000	$10,000	$10,000
2007: 200,000	170,000	170,000	130,000	125,000	45,000	21,000	19,000	20,000	20,000	20,000	20,000
2008: 410,000	350,000	330,000	270,000	240,000	80,000	40,000	40,000	40,000	40,000	40,000	40,000
2009: 600,000	680,000	650,000	560,000	460,000	170,000	70,000	60,000	50,000	40,000	30,000	20,000

(iii) X must initially determine if its base period percentage for the same 6 consecutive months of the 3 preceding taxable years equals or exceeds 70 percent (see section 6655(e)(3) and paragraphs (b) and (c) of this section). By using its taxable income for the first 6 months of 2006, 2007, and 2008, X qualifies for the adjusted seasonal installment method because its base period percentage is 87.5 percent (which exceeds 70 percent) computed as follows:

(A) Taxable income for first 6 months of 2006 = $420,000

(B) Total taxable income for 2006 = $480,000

(C) Divide this paragraph (e), *Example* (iii)(A) by this paragraph (e), *Example* (iii)(B) = .875

(D) Taxable income for first 6 months of 2007 = $840,000

(E) Total taxable income for 2007 = $960,000

(F) Divide this paragraph (e), *Example* (iii)(D) by this paragraph (e), *Example* (iii)(E) = .875

(G) Taxable income for first 6 months of 2008 = $1,680,000

(H) Total taxable income for 2008 = $1,920,000

(I) Divide this paragraph (e), *Example* (iii)(G) by this paragraph (e), *Example* (iii)(H) = .875

(J) Add this paragraph (e), *Example* (iii)(C), (F), and (I) = $2.625

(K) Divide this paragraph (e), *Example* (iii)(J) by 3 = .875

(iv) To determine the amount of the first installment under the rules of section 6655(e)(3) and paragraph (a) of this section, the following computation is necessary:

(A) Taxable income for first 3 months of 2009 = $1,930,000

(B) Taxable income for first 3 months of 2006 ($270,000) divided by total taxable income for 2006 ($480,000) = .5625

(C) Taxable income for first 3 months of 2007 ($540,000) divided by total taxable income for 2007 ($960,000) = .5625

(D) Taxable income for first 3 months of 2008 ($1,090,000) divided by total taxable income for 2008 ($1,920,000) = .5677

(E) Add this paragraph (e), *Example* (iv)(B), (C), and (D) and divide by 3 = .5642

(F) Divide this paragraph (e), *Example* (iv)(A) by this paragraph (e), *Example* (iv)(E) = $3,420,773

(G) Determine the tax on this paragraph (e), *Example* (iv)(F) = $1,163,049

(H) Taxable income for first 4 months of 2006 ($340,000) divided by total taxable income for 2006 ($480,000) = .7083

(I) Taxable income for first 4 months of 2007 ($670,000) divided by total taxable income for 2007 ($960,000) = .6979

(J) Taxable income for first 4 months of 2008 ($1,360,000) divided by total taxable income for 2008 (1,920,000) = .7083

(K) Add this paragraph (e), *Example* (iv)(H), (I), and (J) and divide by 3 = .7048

(L) Multiply this paragraph (e), *Example* (iv)(G) by this paragraph (e), *Example* (iv)(K) = $819,717

(M) 100% of this paragraph (e), *Example* (iv)(L) = $819,717

(N) Amount of all prior required installments for 2009 = $0

(O) Amount of adjusted seasonal installment for the first installment payment (this paragraph (e), *Example* (iv)(M) less this paragraph (e), *Example* (iv)(N)) = $819,717

(v) To determine the amount of the second installment under the rules of section 6655(e)(3) and paragraph (a) of this section, the following computation is necessary:

(A) Taxable income for first 5 months of 2009 = $2,950,000

(B) Taxable income for first 5 months of 2006 ($400,000) divided by total taxable income for 2006 ($480,000) = .8333

(C) Taxable income for first 5 months of 2007 ($795,000) divided by total taxable income for 2007 ($960,000) = .8281

(D) Taxable income for first 5 months of 2008 ($1,600,000) divided by total taxable income for 2008 ($1,920,000) = .8333

(E) Add this paragraph (e), *Example* (v)(B), (C), and (D) and divide by 3 = .8316

(F) Divide this paragraph (e), *Example* (v)(A) by this paragraph (e), *Example* (v)(E) = $3,547,379

(G) Determine the tax on this paragraph (e), *Example* (v)(F) = $1,206,109

(H) Taxable income for first 6 months of 2006 ($420,000) divided by total taxable income for 2006 ($480,000) = .875

(I) Taxable income for first 6 months of 2007 ($840,000) divided by total taxable income for 2007 ($960,000) = .875

(J) Taxable income for first 6 months of 2008 ($1,680,000) divided by total taxable income for 2008 ($1,920,000) = .875

(K) Add this paragraph (e), *Example* (v)(H), (I), and (J) and divide by 3 = .875

(L) Multiply this paragraph (e), *Example* (v)(G) by this paragraph (e), *Example* (v)(K) = $1,055,345

(M) 100% of this paragraph (e), *Example* (v)(L) = $1,055,345

(N) Amount of all prior required installments for 2009 = $163,200

(O) Amount of adjusted seasonal installment for the second installment payment (this paragraph (e), *Example* (v)(M) less this paragraph (e), *Example* (v)(N)) = $892,145

(vi) To determine the amount of the third installment under the rules of section 6655(e)(3) and paragraph (a) of this section, the following computation is necessary:

(A) Taxable income for first 8 months of 2009 = $3,250,000

(B) Taxable income for first 8 months of 2006 ($440,000) divided by total taxable income for 2006 ($480,000) = .9167

(C) Taxable income for first 8 months of 2007 ($880,000) divided by total taxable income for 2007 ($960,000) = .9167

(D) Taxable income for first 8 months of 2008 ($1,760,000) divided by total taxable income for 2008 ($1,920,000) = .9167

(E) Add this paragraph (e), *Example* (vi)(B), (C), and (D) and divide by 3 = .9167

(F) Divide this paragraph (e), *Example* (vi)(A) by this paragraph (e), *Example* (vi)(E) = $3,545,326

(G) Determine the tax on this paragraph (e), *Example* (vi)(F) = $1,205,411

(H) Taxable income for first 9 months of 2006 ($450,000) divided by total taxable income for 2006 ($480,000) = .9375

(I) Taxable income for first 9 months of 2007 ($900,000) divided by total taxable income for 2007 ($960,000) = .9375

(J) Taxable income for first 9 months of 2008 ($1,800,000) divided by total taxable income for 2008 ($1,920,000) = .9375

(K) Add this paragraph (e), *Example* (vi)(H), (I), and (J) and divide by 3 = .9375

(L) Multiply this paragraph (e), *Example* (vi)(G) by this paragraph (e), *Example* (vi)(K) = $1,130,073

(M) 100% of this paragraph (e), *Example* (vi)(L) = $1,130,073

(N) Amount of all prior required installments for 2009 = $576,300

(O) Amount of adjusted seasonal installment for the third installment payment (this paragraph (e), *Example* (vi)(M) less this paragraph (e), *Example* (vi)(N)) = $553,773

(vii) To determine the amount of the fourth installment under the rules of section 6655(e)(3) and paragraph (a) of this section, the following computation is necessary:

(A) Taxable income for first 11 months of 2009 = $3,370,000

(B) Taxable income for first 11 months of 2006 ($470,000) divided by total taxable income for 2006 ($480,000) = .9792

(C) Taxable income for first 11 months of 2007 ($940,000) divided by total taxable income for 2007 ($960,000) = .9792

(D) Taxable income for first 11 months of 2008 ($1,880,000) divided by total taxable income for 2008 ($1,920,000) = .9792

(E) Add this paragraph (e), *Example* (vii)(B), (C), and (D) and divide by 3 = .9792

(F) Divide this paragraph (e), *Example* (vii)(A) by this paragraph (e), *Example* (vii)(E) = $3,441,585

(G) Determine the tax on this paragraph (e), *Example* (vii)(F) = $1,170,139

(H) Taxable income for first 12 months of 2006 ($480,000) divided by total taxable income for 2006 ($480,000) = 1.0000

(I) Taxable income for first 12 months of 2007 ($960,000) divided by total taxable income for 2007 ($960,000) = 1.0000

(J) Taxable income for first 12 months of 2008 ($1,920,000) divided by total taxable income for 2008 ($1,920,000) = 1.0000

(K) Add this paragraph (e), *Example* (vii)(H), (I), and (J) and divide by 3 = 1.0000

(L) Multiply this paragraph (e), *Example* (vii)(G) by this paragraph (e), *Example* (vi)(K) = $1,170,139

(M) 100% of this paragraph (e), *Example* (vii)(L) = $1,170,139

(N) Amount of all prior required installments for 2009 = $864,450

(O) Amount of adjusted seasonal installment for the fourth installment payment (this paragraph (e), *Example* (vii)(M) less this paragraph (e), *Example* (vii)(N)) = $305,689

(viii) Because the total amount of each required estimated tax payment determined under section 6655(e)(3) and paragraph (a) of this section exceeds the amount of each required estimated tax payment determined under section 6655(d) and § 1.6655–1(d) and (e), the exception described in section 6655(e) and this section does not apply and the addition to the tax with respect to the underpayment for the June 15, 2009, and September 15, 2009, installments will be imposed unless another exception (for example, see section 6655(e)(2)) applies with respect to these installments.

(f) *Effective/applicability date.* This section applies to taxable years beginning after September 6, 2007.

■ **Par. 9.** Section 1.6655–4 is added to read as follows:

§ 1.6655–4 Large corporations.

(a) *Large corporation defined.* The term *large corporation* means any corporation (or a predecessor corporation) that had taxable income of at least $1,000,000 for any taxable year during the testing period. For purposes of this section, a predecessor corporation is the distributor or transferor corporation in a transaction to which section 381 (relating to carryovers in certain corporate acquisitions) applies.

(b) *Testing period.* For purposes of paragraph (a) of this section, the term *testing period* means the 3 taxable years immediately preceding the taxable year for which estimated tax is being determined (the current taxable year) or, if less, the number of taxable years the taxpayer has been in existence.

(c) *Computation of taxable income during testing period*—(1) *Short taxable year.* In the case of a corporation (or predecessor corporation) that had a short taxable year during the testing period, for purposes of determining whether the $1,000,000 amount referred to in paragraph (a) of this section is equaled or exceeded, the taxable income for the short taxable year is computed by—

(i) Multiplying the taxable income for the short taxable year by 12; and

(ii) Dividing the resulting amount by the number of months in the short taxable year.

(2) *Computation of taxable income in taxable year when there occurs a transaction to which section 381 applies.* (i) For purposes of determining whether an acquiring corporation had taxable income of $1,000,000 or more for a taxable year in which a section 381 transaction occurs, the acquiring corporation's taxable income will be the sum of—

(A) The taxable income of the acquiring corporation for its taxable year; plus

(B) The taxable income (or loss) of the distributor or transferor corporation for that portion of its taxable year corresponding to the acquiring corporation's taxable year up to and including the date of distribution or transfer (as defined in § 1.381(b)–1(b)).

(ii) For purposes of determining whether a transferor or distributor corporation had taxable income of $1,000,000 or more for a taxable year in which a section 381 transaction occurs, the distributor or transferor corporation's taxable income (or loss) is reduced by the amount of taxable income (or loss) that is included in the acquiring corporation's taxable income for the taxable year in which the distribution or transfer (as defined in § 1.381(b)–1(b)) occurs, as described in paragraph (c)(2)(i)(B) of this section.

(d) *Members of controlled group*—(1) *In general.* For purposes of applying paragraph (a) of this section, the taxable income of members of a controlled group of corporations (as defined in section 1563(a)) must be aggregated for each year of the testing period. The provisions of this section do not apply to a controlled group for any taxable year in which the aggregate taxable income of the members of the controlled group is less than $1,000,000.

(2) *Aggregation.* For purposes of paragraph (d)(1) of this section, a taxable loss of any member of the controlled group for a taxable year during the testing period is not taken into account.

(3) *Allocation rule.* If the aggregate taxable income of members of a controlled group computed pursuant to paragraph (d)(1) of this section exceeds $1,000,000 during the testing period, the $1,000,000 amount that is relevant for purposes of determining, under paragraph (a)(1) of this section, whether a corporation is a large corporation is divided equally among the component members of such group (including component members excluded pursuant to paragraph (d)(2) of this section) unless all of such component members consent to an apportionment plan providing for an alternative allocation of such amount. The procedure for making and filing this plan will be the same as the procedure used for making and filing an apportionment plan under section 1561. See section 1561 and the regulations.

(4) *Controlled group members.* (i) In the case of any corporation that was a member of a controlled group of corporations at any time during the testing period but is not a member of such group during the taxable year involved, the taxable income of the former member for the testing period is determined as if such corporation were not a member of a group at any time during that period. With respect to the controlled group, the taxable income of its former member will not be taken into account in determining such group's taxable income for any taxable year during the testing period for purposes of applying paragraph (a)(1) of this section.

(ii) For purposes of paragraph (d)(4)(i) of this section, the determination of whether a corporation is a member of a controlled group during the testing period is based on whether the corporation was a member of the controlled group on the last day of the month preceding the due date of the required installment.

(e) *Effect on a corporation's taxable income of items that may be carried back or carried over from any other taxable year.* In determining whether a corporation (or predecessor corporation) is a large corporation for its current taxable year, items that could offset taxable income during a taxable year included in the testing period (for example, those described in sections 172 and 1212) are not to be taken into account and the taxable income of a corporation for any taxable year during the testing period is determined without regard to items carried back or carried over from any other taxable year.

(f) *Consolidated returns.* [Reserved].

(g) *Example.* The provisions of this section may be illustrated by the following example:

Example. Y Corporation and Z Corporation are calendar year taxpayers. In 2008, Z acquires all of the assets of Y in a transaction to which section 381 applies. Z's taxable income for both 2006 and 2007 was less than $1,000,000. Y's taxable income for 2008 is determined under paragraph (c)(2) of this section to be $300,000 for that portion of Y's taxable year corresponding to Z's taxable year up to and including the date of transfer. Z's taxable income for 2008 is $800,000. Under the provisions of paragraph (c)(2) of this section, Z's 2008 taxable income for purposes of determining whether it is a large corporation for taxable year 2009 is $1,100,000 ($800,000 + $300,000). Thus, Z is a large corporation for the 2009 taxable year. In addition, if Z's 2008 taxable income, as determined under paragraph (c)(2) of this section, had been less than $1,000,000 but Y's taxable income in 2006 or 2007 had been $1,000,000 or more, Z would be a large corporation for taxable year 2009 because Y is a predecessor corporation.

(h) *Effective/applicability date.* This section applies to taxable years beginning after September 6, 2007.

§ 1.6655–7 [Removed].

■ **Par. 10.** Section 1.6655–7 is removed.

§ 1.6655–5 [Redesignated as § 1.6655–7].

■ **Par. 11.** Section 1.6655–5 is redesignated as § 1.6655–7.

■ **Par. 12.** Sections 1.6655–5 and 1.6655–6 are added to read as follows:

§ 1.6655–5 Short taxable year.

(a) *In general.* Except as otherwise provided in this section, the provisions of section 6655 and these regulations are applicable in the case of a short taxable year (including an initial taxable year) for which a payment of estimated tax is required to be made.

(b) *Exception to payment of estimated tax.* In the case of a short taxable year, no payment of estimated tax is required if—

(1) The short taxable year is a period of less than 4 full calendar months; or

(2) The tax shown on the return for such taxable year (or, if no return is filed, the tax) is less than $500.

(c) *Installment due dates*—(1) *In general*—(i) *Taxable year of at least four months but less than twelve months.* Except as otherwise provided, in the case of a short taxable year, if such year results in a taxable year of four or more full calendar months but less than twelve full calendar months, the due dates prescribed in § 1.6655–1(f)(2) apply.

(ii) *Exceptions.* (A) If the date determined under paragraph (c)(1)(i) of this section for the first required installment due during the taxpayer's short taxable year is earlier than the 15th day of the fourth month of the taxpayer's short taxable year, the taxpayer's first required installment is due on the first due date otherwise determined under paragraph (c)(1)(i) of this section that is on or after the 15th day of the fourth month of the short taxable year.

(B) A taxpayer with an initial short taxable year may make estimated tax payments as though it were a calendar year taxpayer until it files its tax return for its initial taxable year and will not be subject to an addition to tax under section 6655 for making estimated tax payments as though it were a calendar year taxpayer for the period beginning with its initial short taxable year to the time it files its tax return for its initial short taxable year if, when filing its tax return for its initial short taxable year, the taxpayer chooses to be a fiscal year taxpayer.

(2) *Early termination of taxable year*—(i) *In general.* Except as provided in paragraph (c)(2)(ii) of this section, if a taxable year ends early (for example, as a result of an acquisition or a change in taxable year), the due date for the final required installment is the date that would have been the due date of the next required installment if the event that gave rise to the short taxable year had not occurred.

(ii) *Exception.* If the date determined under paragraph (c)(2)(i) of this section is within thirty days of the last day of the short taxable year, the due date for the final required installment is the fifteenth day of the second month following the month that includes the last day of the short taxable year.

(d) *Amount due for required installment*—(1) *In general.* The amount due for any required installment determined under section 6655(d)(1)(B)(i) for a short taxable year is 100% of the required annual payment for the short taxable year divided by the number of required installments due (as determined under this section) for the short taxable year.

(2) *Tax shown on the return for the preceding taxable year.* If the current taxable year is a short taxable year, the amount due for any required installment determined under section 6655(d)(1)(B)(ii) is determined in the following manner—

(i) Take 100% of the tax shown on the return of the corporation for the preceding taxable year;

(ii) Multiply such amount by the number of full calendar months in the current short taxable year and divide by 12; and

(iii) Divide the amount determined under paragraph (d)(2)(ii) of this section by the number of required installments due (as determined under this section) for the current short taxable year.

(3) *Applicable percentage.* In the case of any required installment determined under section 6655(e), the applicable percentage under section 6655(e)(2)(B)(ii) is—

(i) 25%, 50%, 75%, and 100% for the first, second, third, and fourth (last) required installments, respectively, if the taxpayer will have four required installments due for the short taxable year;

(ii) 33.33%, 66.67%, and 100% for the first, second, and third (last) required installments, respectively, if the taxpayer will have three required installments due for the short taxable year;

(iii) 50% and 100% for the first and second (last) required installments, respectively, if the taxpayer will have two required installments due for the short taxable year; or

(iv) 100% for the first (and last) required installment if the taxpayer will have one required installment for the short taxable year.

(4) *Applicable percentage for installment period in which taxpayer does not reasonably expect that the taxable year will be an early termination year.* In the case of any required installment determined under section 6655(e) in which the taxpayer does not reasonably expect that the taxable year will be an early termination year, the applicable percentage under section 6655(e)(2)(B)(ii) is the applicable percentage provided by paragraph (d)(3)(i) of this section with the remaining balance of the estimated tax payment for the year due with the final installment.

(e) *Examples.* The following examples illustrate the rules of this section:

Example 1. Short year of less than 4 months. Corporation A is a calendar year taxpayer that was acquired by corporation B, a member of a consolidated group (as defined in § 1.1502–1(h)) on April 16, 2009, resulting in A having a short taxable year from January 1, 2009, through April 16, 2009. Because A has a taxable year of less than four full calendar months, no estimated tax payments are required by A for the short taxable year.

Example 2. Initial short year with four required installments. Corporation B began business on January 9, 2009, and adopted a calendar year as its taxable year. B computes its required installments based on 100 percent of the tax shown on the return for the taxable year in accordance with section 6655(d)(1)(B)(i). Pursuant to § 1.6655–1(f)(2)(i), the due dates of B's required installments for B's initial taxable year from January 9, 2009, through December 31, 2009, are April 15, 2009, June 15, 2009, September 15, 2009, and December 15, 2009. Pursuant to paragraph (d)(1) of this section, the amount due with each required installment is 25% of the required annual payment for B's first required installment, 50% of the required annual payment for B's second required installment, 75% of the required annual payment for B's third required installment, and 100% of the required annual payment for B's fourth required installment.

Example 3. Initial short year with three required installments. Corporation C began business on February 12, 2009, and adopted a calendar year as its taxable year. C computes its required installments based on 100 percent of the tax shown on the return for the taxable year in accordance with section 6655(d)(1)(B)(i). Pursuant to § 1.6655–1(f)(2)(i), the due dates of C's required installments for C's initial taxable year from February 12, 2009, through December 31, 2009, are April 15, 2009, June 15, 2009, September 15, 2009, and December 15, 2009. However, in accordance with paragraph (c)(1)(ii)(A) of this section, C's first required installment is due June 15, 2009, because April 15, 2009, is earlier than the fifteenth day of the fourth month of C's taxable year. As a result, C's second required installment is due September 15, 2009, and C's third (and last) installment is due December 15, 2009. Pursuant to paragraph (d)(1) of this section, the amount due with each required installment is 33.33% of the required annual payment for C's first required installment, 66.67% of the required annual payment for C's second required installment, and 100% of the required annual payment for C's third (and last) required installment.

Example 4. Initial short year with two required installments. Same facts as *Example 3* except C began business on April 10, 2009. In accordance with paragraph (c)(1)(ii)(A) of this section, C's first required installment is due September 15, 2009, because April 15, 2009, and June 15, 2009, are earlier than the fifteenth day of the fourth month of C's taxable year. As a result, C's second (and last) required installment is due December 15, 2009. Pursuant to paragraph (d)(1) of this section, the amount due with each required installment is 50% of the required annual payment for C's first required installment, and 100% of the required annual payment for C's second (and last) required installment.

Example 5. Initial short year for fiscal year taxpayer with two required installments. Corporation D began business on February 12, 2009, and adopted a fiscal year ending October 31 as its taxable year. D computes its required installments based on 100 percent of the tax shown on the return for the taxable year in accordance with section 6655(d)(1)(B)(i). Pursuant to § 1.6655–1(f)(2)(ii), the due dates of D's required installments for D's initial taxable year from February 12, 2009, through October 31, 2009, are February 15, 2009, April 15, 2009, July 15, 2009, and October 15, 2009. However, in accordance with paragraph (c)(1)(ii)(A) of this section, D's first required installment is due July 15, 2009, because February 15, 2009, and April 15, 2009, are earlier than the fifteenth day of the fourth month of D's taxable year. As a result, D's second (and last) installment is due October 15, 2009. Pursuant to paragraph (d)(1) of this section, the amount due with each required installment is 50% of the required annual payment for D's first required installment, and 100% of the required annual payment for D's second (and last) required installment.

Example 6. Initial short year for fiscal year taxpayer with one required installment. Same facts as *Example 5* except D corporation began business on May 11, 2009. In accordance with paragraph (c)(1)(ii)(A) of this section, D's first (and last) installment is due October 15, 2009, because July 15, 2009, is earlier than the fifteenth day of the fourth month of D's taxable year. Pursuant to paragraph (d)(1) of this section, the amount due with D's required installment is 100% of the required annual payment, computed as 100% divided by the number of required installments due for the short taxable year.

Example 7. Short termination year with three required installments. Corporation E is a calendar year taxpayer that computes its required installments based on 100 percent of the tax shown on the return for the taxable year in accordance with section 6655(d)(1)(B)(i). E computes its 2009 required installments based on a projected 2009 total tax liability of $600,000. On July 31, 2009, E is acquired by corporation F, a member of a consolidated group (as defined in § 1.1502–1(h)), resulting in E having a short taxable year from January 1, 2009, through July 31, 2009. E determines that its total tax liability for the short period is $350,000. The due dates for E's first and second required installments are April 15, 2009, and June 15, 2009, respectively. Pursuant to section 6655(d)(1)(A), E paid $150,000 with each required installment. Pursuant to paragraph (c)(2) of this section, E's third (and last) required installment of estimated tax is due on September 15, 2009, and the percentage of the required annual payment due with such installment is 100% pursuant to paragraph (d)(1) of this section. Accordingly, E is required to pay $50,000 with its final required installment on September 15, 2009 ($350,000 total tax liability for the short taxable year less prior installment payments of $300,000).

Example 8. Unexpected short termination year with three required installments using the annualization method. Same facts as *Example 7* except that E uses the annualized income installment method under section 6655(e)(2)(A)(i) to calculate all of its required installment payments for its 2009 taxable year. In addition, E does not reasonably expect until July 28, 2009, that it will have a short termination year caused by E being acquired by F on July 31, 2009. Had E known about its acquisition by F in the first quarter of 2009, E's applicable percentages for computing the amount of its three required installments would be 33.33%, 66.67%, and 100% for the first, second, and third (last) required installments, respectively, pursuant to paragraph (d)(3)(ii) of this section. However, because E had an unexpected short termination year that E was not aware of until after its second required installment payment, E's applicable percentages for computing the amount of its three required installment are 25%, 50%, and 100% for the first, second, and third (last) required installments, respectively, pursuant to paragraph (d)(4) of this section.

Example 9. Short termination year ending within 30 days of the regular final installment due date. Same facts as *Example 7* except that E is acquired by F on August 31, 2009. Pursuant to paragraph (c)(2)(ii) of this section, E's third (and last) required installment of estimated tax is due on October 15, 2009, because September 15, 2009, the date that would have been the due date of E's next required installment if F's acquisition of E had not occurred, is within thirty days of the last day of E's short taxable year, and 100% of the required annual payment is due with such installment.

Example 10. Short termination year ending within 30 days of the regular final installment due date. Corporation F is a calendar year taxpayer that computes its required installments based on 100 percent of the tax shown on the return for the taxable year in accordance with section 6655(d)(1)(B)(i). F computes its 2009 estimated tax payments based on a projected 2009 total tax liability of $900,000. On December 3, 2009, F is acquired by corporation G, a member of a consolidated group (as defined in § 1.1502–2(h)), resulting in F having a short taxable year from January 1, 2009, through December 3, 2009. F determined its total tax liability for the short period to be $800,000. The due dates for F's first, second, and third required installments are April 15, 2009, June 15, 2009, and September 15, 2009, respectively. Pursuant to section 6655(d)(1)(A), F paid $225,000 with each required installment. Pursuant to paragraph (c)(2)(ii) of this section, F's fourth (and last) required installment of estimated tax is due on February 15, 2010, and the percentage of the required annual payment due with such installment is 100% pursuant to paragraph (d)(1) of this section. However, because the due date for the fourth required installment falls on a legal holiday, F's required installment payment will be timely if paid on or before the first business day following the actual due date of the fourth required installment, that is, February 16, 2010. Accordingly, F is required to pay $125,000 with its final required installment on February 16, 2010 ($800,000 total tax liability for the short taxable year less prior installment payments of $675,000).

Example 11. Short termination year using the tax shown on the return for the preceding taxable year. Corporation G, a calendar year taxpayer, reported a tax liability of $75,000 on its return for the taxable year ending December 31, 2008, and is not a large corporation as defined in section 6655(g). On July 31, 2009, G makes a final distribution of its assets, in connection with a plan of complete liquidation, resulting in a short taxable year from January 1, 2009, through July 31, 2009. To satisfy the requirements of the exception described in section 6655(d)(1)(B)(ii) for payments determined by reference to the tax shown on the return of the corporation for the preceding taxable year, pursuant to paragraph (d)(2) of this section, G must pay in a proportionate amount of its 2008 tax liability based on the number of months in the current taxable year. Accordingly, G must pay $43,750 ($75,000 × 7⁄12) through payments of estimated tax payments in 2009, with $14,583 due on April 15, 2009, June 15, 2009, and September 15, 2009.

Example 12. Short termination year using the tax shown on the return for the preceding taxable year. Same facts as *Example 11* except that G makes a final distribution of its assets, in connection with a plan of complete liquidation, on October 1, 2009, resulting in a short taxable year from January 1, 2009, through October 1, 2009. To satisfy the requirements of the exception described in section 6655(d)(1)(B)(ii), G must pay $56,250 ($75,000 × 9⁄12) through payments of estimated tax in 2009, with $14,063 due on April 15, 2009, June 15, 2009, September 15, 2009, and December 15, 2009, respectively.

Example 13. Short initial year with three required installments resulting in an underpayment. (i) Corporation H began business on February 17, 2009, and adopted a calendar year. H computes its required installments based on 100 percent of the tax shown on the return for the taxable year in accordance with section 6655(d)(1)(B)(i). H estimated at the beginning of its short taxable year that its estimated tax liability for short taxable year February 17, 2009, through December 31, 2009, would be $180,000. H paid its first required installment of estimated tax of $60,000 on June 15, 2009, its second required installment of estimated tax of $60,000 on September 15, 2009, and its third (and last) required installment of estimated tax of $60,000 on December 15, 2009 ($180,000 total estimated tax liability for the short taxable year less prior installment payments of $120,000). H reported a tax liability of $240,000 on its return for the short period February 17, 2009, through December 31, 2009, with no credits against tax. There was an underpayment in the amount of $20,000 on the first installment date through September 15, 2009, $40,000 on the second installment date through December 15, 2009, and $60,000 on the third (and last) installment date through March 15, 2010, determined as follows:

(A) Tax as defined in section 6655(d)(1)(B)(i) = $240,000

(B) 100% of this paragraph (e), *Example 13* (A) = $240,000

(C) Amount of estimated tax required to be paid by the first installment date (33.33% of $240,000) = $80,000

(D) Amount of estimated tax required to be paid by the second installment date (66.67% of $240,000 less $80,000 (amount due with first installment)) = $80,000

(E) Amount of estimated tax required to be paid by the third installment date (100% of $240,000 less $160,000 (amount due with first and second installment)) = $80,000

(F) Deduction of amount paid on or before the first installment date = $60,000

(G) Amount of underpayment for the first installment date (this paragraph (e), *Example 13* (i)(C) minus this paragraph (e), *Example 13* (i)(F)) = $20,000

(H) Deduction of amount available for the second installment date ($60,000 second installment payment less this paragraph (e), *Example 13* (i)(G) applied towards the first installment underpayment) = $40,000

(I) Amount of underpayment for the second installment date (this paragraph (e), *Example 13* (i)(D) minus this paragraph (e), *Example 13* (i)(H)) = $40,000

(J) Deduction of amount available for the third installment date ($60,000 third installment payment less this paragraph (e), *Example 13* (i)(I) applied towards the second installment underpayment) = $20,000

(K) Amount of underpayment for the third installment date (this paragraph (e), *Example 1* (i)(E) minus this paragraph (e), *Example 13* (i)(J)) = $60,000

(ii) [Reserved].

(f) *52 or 53 week taxable year.* For purposes of this section a taxable year of 52 or 53 weeks is deemed a period of 12 months in the case of a corporation that computes its taxable income in accordance with the election permitted by section 441(f).

(g) *Use of annualized income or seasonal installment method*—(1) *In general*. Regardless of the annual accounting period used by a corporation (for example, calendar year, fiscal year) the taxpayer may use the method described in § 1.6655–2 (annualized income installment method) or § 1.6655–3 (adjusted seasonal installment method) to compute its required installments of estimated tax when the current taxable year is a short taxable year.

(2) *Computation of annualized income installment.* To the extent a short taxable year includes an annualization period elected by the taxpayer, the taxpayer computes its annualized income installment by determining the tax on the basis of such annualized income for the annualization period, divided by 12, multiplied by the number of months in the short taxable year, and multiplied by the applicable percentage for the required installment.

(3) *Annualization period for final required installment.* For purposes of determining the final required installment (as described in paragraph (c)(2) of this section) for a short taxable year, annualized taxable income is determined by placing on an annualized basis the taxable income for the last complete annualization period that occurs within the short taxable year.

(4) *Examples.* The provisions of paragraph (g) of this section may be illustrated by the following examples:

Example 1. Corporation X began business on February 12, 2009, and adopted a calendar year as its taxable year. X adopts an accrual method of accounting and uses the annualized income installment method under section 6655(e)(2)(A)(i) to calculate all of its required installment payments for its 2009 taxable year. Pursuant to § 1.6655–1(f)(2)(i), the due dates of X's required installments for X's initial taxable year from February 12, 2009, through December 31, 2009, are April 15, 2009, June 15, 2009, September 15, 2009, and December 15, 2009. However, in accordance with paragraph (c)(1)(ii)(A) of this section, X's first required installment is due June 15, 2009. As a result, X's second required installment is due September 15, 2009, and X's third (and last) required installment is due December 15, 2009. The amount of X's first and second required installments are each based on annualizing X's taxable income from February 12, 2009, through April 30, 2009, (the first three months of X's taxable year) and X's third (and last) required installment is based on annualizing X's taxable income from February 12, 2009, through July 31, 2009 (the first six months of X's taxable year). Because X will have three required installments due for its short taxable year, pursuant to paragraph (d)(3)(ii) of this section, the applicable percentage is 33.33% for X's first required installment, 66.67% for X's second required installment, and 100% for X's third (and last) required installment.

Example 2. (i) Y, a calendar year corporation, made a final distribution of its assets, in connection with a plan of complete liquidation, on August 3, 2009. Y filed a timely election to use the alternative annualization periods described under section 6655(e)(2)(C)(i) and determined that its taxable income for the first 2, 4 and 7 months of the taxable year was $25,000, $50,000 and $140,000. The due dates for Y's required installments for its short taxable year January 1, 2009, through August 3, 2009, are April 15, 2009, June 15, 2009, and September 15, 2009. Y made installment payments of $10,000, $10,000, and $20,000, respectively, on April 15, 2009, June 15, 2009, and September 15, 2009. The taxable income for each period is annualized as follows:

$25,000 × 12/2 = $150,000
$50,000 × 12/4 = $150,000
$140,000 × 12/7 = $240,000

(ii)(A) To determine whether the first required installment equals or exceeds the amount that would have been required to have been paid if the estimated tax were equal to one hundred percent of the tax computed on the annualized income for the 2-month period taking into account the number of months in the short taxable year, the following computation is necessary:

(*1*) Annualized income for the 2 month period = $150,000

(*2*) Tax on this paragraph (g)(4), *Example 2* (ii)(A)(*1*) = $41,750

(*3*) Tax determined under this paragraph (g)(4), *Example 2* (ii)(A)(*2*) divided by 12 multiplied by 7 (the number of months in the short taxable year) = $24,354

(*4*) 100% of this paragraph (g)(4), *Example 2* (ii)(A)(*3*) = $24,354

(*5*) 33.33% of this paragraph (g)(4), *Example 2* (ii)(A)(*4*) = $ 8,117

(B) Because the total amount of estimated tax that is timely paid on or before the first installment date ($10,000) exceeds the amount required to be paid on or before this date if the estimated tax were one hundred percent of the tax determined by placing on an annualized basis the taxable income for the first 2-month period taking into account the number of months in the short taxable year, the exception described in § 1.6655–2(a) applies and no addition to tax will be imposed for the installment due on April 15, 2009.

(iii)(A) To determine whether the required installments made on or before June 15, 2009, equal or exceed the amount that would have been required to have been paid if the estimated tax were equal to one hundred percent of the tax computed on the annualized income for the 4-month period taking into account the number of months in the short taxable year, the following computation is necessary:

(*1*) Annualized income for the 4 month period = $150,000

(*2*) Tax on this paragraph (g)(4), *Example 2* (iii)(A)(*1*) = $41,750

(*3*) Tax determined under this paragraph (g)(4), *Example 2* (iii)(A)(*2*) divided by 12 multiplied by 7 (the number of months in the short taxable year) = $24,354

(*4*) 100% of this paragraph (g)(4), *Example 2* (iii)(A)(*3*) = $24,354

(*5*) 66.67% of this paragraph (g)(4), *Example 2* (iii)(A)(*4*) less $8,117 (amount due with first installment) = $8,120

(B) Because the total amount of estimated tax available to apply towards the amount due for the second installment ($11,883 ($10,000 paid on the second installment date plus $1,883 overpayment of the first installment)) exceeds the amount required to be paid on or before this date if the estimated tax were one hundred percent of the tax determined by placing on an annualized basis the taxable income for the first 4-month period for the taxable year taking into account the number of months in the short taxable year, the exception described in § 1.6655–2(a) applies and no addition to tax will be imposed for the installment due on June 15, 2009.

(iv)(A) Pursuant to paragraph (c) and (d) of this section, the final required installment is due by September 15, 2009, and the applicable percentage due for the final required installment is 100%. To determine whether the installment payments made on or before September 15, 2009, equal or exceed the amount that would have been required to have been paid if the estimated tax were equal to one hundred percent of the tax computed on the annualized income for the 7-month period taking into account the number of months in the short taxable year, the following computation is necessary:

(*1*) Annualized income for the 7 month period = $240,000

(*2*) Tax on this paragraph (g)(4), *Example 2* (iv)(A)(*1*) = $76,850

(*3*) Tax determined under this paragraph (g)(4), *Example 2* (iv)(A)(*2*) divided by 12 multiplied by 7 (the number of months in the short taxable year) = $44,829

(*4*) 100% of this paragraph (g)(4), *Example 2* (iv)(A)(*3*) = $44,829

(*5*) 100% of this paragraph (g)(4), *Example 2* (iv)(A)(*4*) less $16,237 (amount due with first and second installment) = $28,592

(B) Because the total amount of estimated tax available to apply towards the amount due for the final installment ($23,763 ($20,000 that is timely paid on the third installment date plus $3,763 overpayment of the second installment)) does not exceed the amount required to be paid on or before this date if the estimated tax were one hundred percent of the tax determined by placing on an annualized basis the taxable income for the first 7-month period for the taxable year taking into account the number of months in the short taxable year, the exception described in § 1.6655–2(a) does not apply and an addition to tax will be imposed for the final installment due on September 15, 2009, unless another exception (for example, see section 6655(e)(3)) applies with respect to these installments.

(h) *Effective/applicability date.* This section applies to taxable years beginning after September 6, 2007.

§ 1.6655–6 Methods of accounting.

(a) *In general.* In computing any required installment, a corporation must use the methods of accounting used in computing taxable income for the taxable year for which estimated tax is being determined (the current taxable year).

(b) *Accounting method changes.* A taxpayer that changes its method of accounting with the consent of the Commissioner for the current taxable year must use the new method of accounting (as of the beginning of the taxable year) in the determination of taxable income for annualization periods ending on or after the date the related section 481(a) adjustment is treated as arising. See § 1.6655–2(f)(3)(ii)(C) for the date a section 481(a) adjustment is treated as arising. If the change in method of accounting does not result in a section 481(a) adjustment, the taxpayer may choose to use the new method of accounting (as of the beginning of the taxable year) in the determination of taxable income for all annualization periods during the year of change or only those annualization periods ending on or after the date the Form 3115 ''Application for Change in Accounting Method'' was filed with the national office of the Internal Revenue Service. This paragraph (b) only applies to the extent a taxpayer changes a method of accounting for the taxable year with the consent of the Commissioner. Therefore, a taxpayer may be subject to a section 6655 addition to tax for an underpayment of estimated tax if an underpayment results from a change in a method of accounting the taxpayer anticipates making for the taxable year but for which the consent of the Commissioner is not subsequently received.

(c) *Examples.* The following examples illustrate the rules of this section:

Example 1. Accounting method used in computing taxable income for the taxable year. Corporation ABC, a calendar year taxpayer, uses an accrual method of accounting and the annualization method under section 6655(e)(2)(A)(i) to calculate all of its 2008 required installments. ABC receives advance payments each taxable year with respect to agreements for the sale of goods properly includible in ABC's inventory. The advance payments received by ABC qualify for deferral under § 1.451–5(c). Although ABC is eligible to defer the advance payments in accordance with § 1.451–5(c), ABC's method of accounting with respect to the advance payments is to include the advance payments in income when received and ABC does not change its accounting method for advance payments for the 2008 taxable year. ABC must use its current method of recognizing advance payments as income in the year received for purposes of computing its 2008 required installments.

Example 2. Change of accounting method. Corporation ABC, a calendar year taxpayer, uses an accrual method of accounting and the annualization method under section 6655(e)(2)(A)(i) to calculate all of its 2008 required installments. On June 15, 2008, ABC files a Form 3115 requesting permission to change its method of accounting for future litigation reserves for the tax year ending December 31, 2008. On February 15, 2009, ABC receives consent from the Commissioner to make the change for the tax year ending December 31, 2008. The change results in a positive section 481(a) adjustment of $100,000. Under the provisions of § 1.6655–2(f)(3)(ii) ABC chooses to treat the section 481(a) adjustment as arising on the date the Form 3115 is filed with the national office of the Internal Revenue Service. Therefore, ABC is required to use the new method of accounting (as of the beginning of the year) in the determination of taxable income for annualization periods ending on or after June 15, 2008.

(d) *Effective/applicability date.* This section applies to taxable years beginning after September 6, 2007.

■ **Par. 13.** Newly-designated § 1.6655–7 is revised to read as follows:

§ 1.6655–7 Addition to tax on account of excessive adjustment under section 6425.

(a) Section 6655(h) imposes an addition to the tax under chapter 1 of the Internal Revenue Code in the case of any excessive amount (as defined in paragraph (c) of this section) of an adjustment under section 6425 that is made before the 15th day of the third month following the close of a taxable year beginning after December 31, 1967. This addition to tax is imposed whether or not there was reasonable cause for an excessive adjustment.

(b) If the amount of an adjustment under section 6425 is excessive, there shall be added to the tax under chapter 1 of the Internal Revenue Code for the taxable year an amount determined at the annual rate referred to in the regulations under section 6621 upon the excessive amount from the date on which the credit is allowed or refund paid to the 15th day of the third month following the close of the taxable year. A refund is paid on the date it is allowed under section 6407.

(c) The excessive amount is equal to the lesser of the amount of the adjustment or the amount by which—

(1) The income tax liability (as defined in section 6425(c)) for the taxable year, as shown on the return for the taxable year; exceeds

(2) The estimated income tax paid during the taxable year, reduced by the amount of the adjustment.

(d) The computation of the addition to the tax imposed by section 6425 is made independent of, and does not affect the computation of, any addition to the tax that a corporation may otherwise owe for an underpayment of an installment of estimated tax.

(e) The following example illustrates the rules of this section:

Example. (i) Corporation X, a calendar year taxpayer, had an underpayment as defined in section 6655(b), for its fourth installment of estimated tax that was due on December 15, 2009, in the amount of $10,000. On January 4, 2010, X filed an application for adjustment of overpayment of estimated income tax for 2009 in the amount of $20,000.

(ii) On February 16, 2010, the Internal Revenue Service, in response to the application, refunded $20,000 to X. On March 15, 2010, X filed its 2009 tax return and made a payment in settlement of its total tax liability. Assuming that the addition to tax is computed under section 6621(a)(2) at a rate of 8% per annum for the applicable periods of underpayment, under section 6655(a), X is subject to an addition to tax in the amount of $197 (90/365 X $10,000 X 8%) on account of X's December 15, 2009, underpayment. Under section 6655(h), X is subject to an addition to tax in the amount of $118 (27/365 X $20,000 X 8%) on account of X's excessive adjustment under section 6425. In determining the amount of the addition to tax under section 6655(a) for failure to pay estimated income tax, the excessive adjustment under section 6425 is not taken into account.

(f) An adjustment is generally to be treated as a reduction of estimated income tax paid as of the date of the adjustment. However, for purposes of §§ 1.6655–1 through 1.6655–6, the adjustment is to be treated as if not made in determining whether there has been any underpayment of estimated income tax and, if there is an underpayment, the period during which the underpayment existed.

(g) *Effective/applicability date:* This section applies to taxable years beginning after September 6, 2007.

PART 301—PROCEDURE AND ADMINISTRATION

■ **Par. 14.** The authority citation for part 301 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

§ 301.6154–1 [Removed].

■ **Par. 15.** Section 301.6154–1 is removed.

■ **Par. 16.** Section 301.6655–1 is revised to read as follows:

§ 301.6655–1 Failure by corporation to pay estimated income tax.

(a) For regulations under section 6655, see §§ 1.6655–1 through 1.6655–7 of this chapter.

(b) *Effective/applicability date:* This section applies to taxable years beginning after September 6, 2007.

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

■ **Par. 17.** The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

§ 602.101 [Amended].

■ **Par. 18.** Section 602.101, paragraph (b) is amended by removing the entries for §§ 1.6154–2, 1.6154–3, 1.6154–5, 1.6655–1, 1.6655–2, 1.6655–3 and 1.6655–7.

Kevin M. Brown,

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Approved: July 17, 2007.

Eric Solomon,

Assistant Secretary of the Treasury (Tax Policy).

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