

B. The remaining 20 percent of B is owned by employees of B. The fair market value of A, including its 80 percent interest in B, as of the last day of the testing period, is \$1,000,000. In addition, the fair market value of the 20 percent interest in B owned by B's employees is \$5,000 as of the last day of the testing period. Pursuant to paragraph (d)(1)(iv) and paragraph (i)(1) of this section, AB must determine whether the employee-owners of A and B (*i.e.*, B's employees) own more than 10 percent of the fair market value of A and B as of the last day of the testing period. Since the \$14,000 [(\$100,000.09) + \$5,000] fair market value of the stock held by B's employees is greater than 10 percent of the \$105,000 (\$100,000 + \$5,000) aggregate fair market value of A and B as of the last day of the testing period, AB may be subject to this section if, on a consolidated basis during the testing period, (a) the principal activity of AB is the performance of personal services and (b) the personal services are substantially performed by employee-owners.

(j) *Effective date.* This section applies to taxable years beginning after December 31, 1986.

[T.D. 8167, 52 FR 48528, Dec. 23, 1987]

**§ 1.442-1 Change of annual accounting period.**

(a) *Manner of effecting such change—*  
 (1) *In general.* If a taxpayer wishes to change his annual accounting period (as defined in section 441(c)) and adopt a new taxable year (as defined in section 441(b)), he must obtain prior approval from the Commissioner by application, as provided in paragraph (b) of this section, or the change must be authorized under the Income Tax Regulations. A new taxpayer who adopts an annual accounting period as provided in section 441 and §§ 1.441-1 or 1.441-2 need not secure the permission of the Commissioner under section 442 and this section. However, see subparagraph (2) of this paragraph. For adoption of and changes to or from a 52-53-week taxable year, see section 441(f) and § 1.441-2; for adoption of and changes in the taxable years of partners and partnerships, see paragraph (b)(2) of this section, section 706(b) and paragraph (b) of § 1.706-1; for special rules relating to certain corporations, subsidiary corporations, and newly married couples, see paragraphs (c), (d), and (e), respectively, of this section. For special rules relating to real

estate investment trusts, see section 859.

(2) *Taxpayers to whom section 441(g) applies.* Section 441(g) provides that if a taxpayer keeps no books, does not have an annual accounting period, or has an accounting period which does not meet the requirements for a fiscal year, his taxable year shall be the calendar year. If section 441(g) applies to a taxpayer, the adoption of a fiscal year will be treated as a change in his annual accounting period under section 442. Therefore, such fiscal year can become the taxpayer's taxable year only with the approval of the Commissioner. Approval of any such change will be denied unless the taxpayer agrees in his application to establish and maintain accurate records of his taxable income for the short period involved in the change and for the fiscal year proposed. The keeping of records which adequately and clearly reflect income for the taxable year constitutes the keeping of books within the meaning of section 441(g) and paragraph (g) of § 1.441-1.

(b) *Prior approval of the Commissioner—*(1) *In general.* In order to secure prior approval of a change of a taxpayer's annual accounting period, the taxpayer must file an application on Form 1128 with the Commissioner of Internal Revenue, Washington, D.C. 20224, to effect the change of accounting period. If the short period involved in the change ends after December 31, 1973, such form shall be filed on or before the 15th day of the second calendar month following the close of such short period; if such short period ends before January 1, 1974, such form shall be filed on or before the last day of the first calendar month following the close of such short period. Approval will not be granted unless the taxpayer and the Commissioner agree to the terms, conditions, and adjustments under which the change will be effected. In general, a change of annual accounting period will be approved where the taxpayer established a substantial business purpose for making the change. In determining whether a taxpayer has established a substantial business purpose for making the change, consideration

will be given to all the facts and circumstances relating to the change, including the tax consequences resulting therefrom. Among the nontax factors that will be considered in determining whether a substantial business purpose has been established is the effect of the change on the taxpayer's annual cycle of business activity. The agreement between the taxpayer and the Commissioner under which the change will be effected shall, in appropriate cases, provide terms, conditions, and adjustments necessary to prevent a substantial distortion of income which otherwise would result from the change. The following are examples of effects of the change which would substantially distort income:

(i) Deferral of a substantial portion of the taxpayer's income, or shifting of a substantial portion of deductions, from one year to another so as to reduce substantially the taxpayer's tax liability;

(ii) Causing a similar deferral or shifting in the case of any other person, such as a partner, a beneficiary, or a shareholder in an electing small business corporation as defined in selection 1371(b); or

(iii) Creating a short period in which there is either (a) a substantial net operating loss, or (b) in the case of an electing small business corporation, a substantial portion of amounts treated as long-term capital gain.

Even though a substantial business purpose is not established, the Commissioner in appropriate cases may permit a husband or wife to change his or her taxable year in order to secure the benefits of section 1(a) (relating to tax in case of a joint return). See paragraph (e) of this section for special rule for newly married couples.

(2) *Partnerships and partners.* (i) A newly-formed partnership may adopt a taxable year which is the same as the taxable year of all its principal partners (or is the same taxable year to which its principal partners who do not have such taxable year concurrently change) without securing prior approval from the Commissioner. If all its principal partners are not on the same taxable year, a newly-formed partnership may adopt a calendar year without securing prior approval from

the Commissioner. If a newly-formed partnership wishes to adopt a taxable year that does not qualify under the preceding two sentences, the adoption of such year requires the prior approval of the Commissioner in accordance with section 706(b)(1) and paragraph (b) of § 1.706-1. An existing partnership may change its taxable year without securing prior approval from the Commissioner if all its principal partners have the same taxable year to which the partnership changes, or if all its principal partners who do not have such a taxable year concurrently change to such taxable year. In any other case, an existing partnership may not change its taxable year unless it secures the prior approval of the Commissioner in accordance with paragraph (b)(1) of this section and section 706(b)(1) and paragraph (b) of § 1.706-1.

(ii) A partner may change his taxable year only if he secures the prior approval of the Commissioner in accordance with paragraph (b)(1) of this section.

(3) *Certain foreign corporations.* Application for approval to change such taxable year of either a controlled foreign corporation (as defined in section 957 or a foreign corporation that meets the stock ownership requirements of a foreign personal holding company (as defined in section 552) shall be made by filing an application in accordance with paragraph (b)(1) of this section. The application shall be made by one or more of such controlled foreign corporation's United States shareholders (as defined in section 951(b)), by one or more individuals who comprise a foreign corporation's "United States group" (as defined in section 552(a)(2)), or by the respective corporations. In general, a change of such a taxable year will be approved if the annual accounting period of such controlled foreign corporation or foreign corporation meeting the stock ownership requirements of a foreign personal holding company is changed to conform to the requirements of foreign law or because bona fide foreign business reasons make such a change necessary or desirable and the other applicable provisions of paragraph (b)(1) of this section are satisfied.

(c) *Special rule for certain corporations.*

(1) Except as otherwise provided in paragraph (c)(4) and (5) of this section and under section 859, a corporation may change its annual accounting period without the prior approval of the commissioner if all the conditions in subparagraph (2) of this paragraph are met, and if the corporation files a statement with the district director with whom the returns of the corporation are filed at or before the time (including extension) for filing the return for the short period required by such change. This statement shall indicate that the corporation is changing its annual accounting period under paragraph (c) of this section and shall contain information indicating that all of the conditions in subparagraph (2) of this paragraph have been met.

(2) The provisions of this paragraph do not apply unless all of the following conditions are met:

(i) The corporation has not changed its annual accounting period at any time within the ten calendar years ending with the calendar year which includes the beginning of the short period required to effect the change of annual accounting period;

(ii) The short period required to effect the change of annual accounting period is not a taxable year in which the corporation has a net operating loss as defined in section 172;

(iii) The taxable income of the corporation for the short period required to effect the change of annual accounting period is, if placed on an annual basis (see paragraph (b)(1) (i) and (ii) of § 1.443-1), 80 percent or more of the taxable income of the corporation for the taxable year immediately preceding such short period;

(iv) If a corporation had a special status either for the short period or for the taxable year immediately preceding such short period, it must have the same special status for both the short period and such taxable year (for the purpose of this subdivision, special status includes only: a personal holding company, a corporation that is an exempt organization, a foreign corporation not engaged in a trade or business within the United States, a Western Hemisphere trade corporation, and a China Trade Act corporation); and

(v) The corporation does not attempt to make an election under section 1372(a) that purports to initially become effective with respect to a taxable year which (a) would immediately follow the short period required to effect the change of annual accounting period, and (b) would begin after August 23, 1972.

(3) If the Commissioner finds upon examination of the returns that the corporation, because of subsequent adjustments in establishing tax liability, did not in fact meet all the conditions in subparagraph (2) of this paragraph, the statement filed under subparagraph (1) of this paragraph shall be considered as a timely application for permission to change the corporation's annual accounting period to the taxable year indicated in the statement.

(4) A corporation which is an electing small business corporation (as defined in section 1371(b)) or a DISC (as defined in section 992(a)(1)) during the short period required to effect the change of annual accounting period may change its taxable year only if it secures the prior approval of the Commissioner in accordance with paragraph (b)(1) of this section. This subparagraph shall apply only if such short period ends after February 28, 1959. See subparagraphs (3)(ii) and (4) of § 1.991-1(b) for special rules relating to the change of a DISC's annual accounting period during 1972.

(5) A controlled foreign corporation (as defined in section 957) or a foreign corporation that meets the stock ownership requirements of a foreign personal holding company (as defined in section 552) may change its taxable year only if it secures the prior approval of the Commissioner in accordance with paragraph (b) (1) and (3) of this section. A controlled foreign corporation or a foreign corporation that meets the stock ownership requirements of a foreign personal holding company that is not subject to United States income tax shall be treated for the purposes of this section as a taxpayer within the meaning of section 7701(a)(14).

(d) *Special rule for change of annual accounting period by subsidiary corporation.* A subsidiary corporation which is

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required to change its annual accounting period under § 1.1502-76, relating to the taxable year of members of an affiliated group which file a consolidated return, need not file an application on Form 1128 with respect to such change.

(e) *Special rule for newly married couples.* (1) A newly married husband or wife may change his or her annual accounting period in order to adopt the annual accounting period of the other spouse so that a joint return may be filed for the first or second taxable year of such spouse ending after the date of marriage, provided that the newly married husband or wife adopting the annual accounting period of the other spouse files a return for the short period required by such change on or before the 15th day of the 4th month following the close of such short period. See section 443 and the regulations thereunder. (If the due date for any such short-period return occurs before the date of marriage, the first taxable year of the other spouse ending after the date of marriage cannot be adopted under this paragraph.) The short-period return shall contain a statement that it is filed under authority of this paragraph. For a change of annual accounting period by a husband or wife which does not qualify under this subparagraph, see paragraph (b) of this section.

(2) The provisions of this paragraph may be illustrated by the following example:

*Example.* H & W marry on September 25, 1956. H is on a fiscal year ending June 30, and W is on a calendar year. H wishes to change to a calendar year in order to file joint returns with W. W's first taxable year after marriage ends on December 31, 1956. H may not change to a calendar year for 1956 since, under paragraph (e) of § 1.442-1, he would have had to file a return for the short period from July 1 to December 31, 1955, by April 15, 1956. Since the date of marriage occurred subsequent to this due date, the return could not be filed under paragraph (e) of § 1.442-1. Therefore, H cannot change to a calendar year for 1956. However, H may change to a calendar year for 1957 by filing a return under paragraph (e) of § 1.442-1 by April 15, 1957, for the short period from July 1 to December 31, 1956. If H files such a return, H and W may file a joint return for calendar year 1957 (which is W's second taxable year ending after the date of marriage).

(f) *Effective date.* The provisions of this section (other than paragraphs (c)(4) and (e) thereof) are effective for any change of annual accounting period where the last day of the short period required to effect the change ends on or after March 1, 1957. For special rules applicable to certain changes of annual accounting period that result in a short period ending in 1986 or 1987, see § 1.442-2T. For special rules applicable to certain adoptions and retentions of a taxable year ending in 1986 or 1987, see § 1.442-3T.

(Secs. 860(e), (92 Stat. 2849, 26 U.S.C. 860(e)); sec. 860(g) (92 Stat. 2850, 26 U.S.C. 860(g)); and sec. 7805 (68A Stat. 917, 26 U.S.C. 7805))

[T.D. 6500, 25 FR 11703, Nov. 26, 1960, as amended by T.D. 6614, 27 FR 10098, Oct. 13, 1962; T.D. 7235, 37 FR 28624, Dec. 28, 1972; T.D. 7244, 37 FR 28897, Dec. 30, 1972; T.D. 7286, 38 FR 26911, Sept. 27, 1973; T.D. 7323, 39 FR 34409, Sept. 25, 1974; T.D. 7470, 42 FR 12178, Mar. 3, 1977; T.D. 7767, 46 FR 11265, Feb. 6, 1981; T.D. 7936, 49 FR 2106, Jan. 18, 1984; T.D. 8123, 52 FR 3619, Feb. 5, 1987]

### § 1.442-2T Special limitations on certain changes of annual accounting period (temporary).

(a) *Applicability.* This section applies to any taxpayer that wishes to change its annual accounting period, or that wishes to adopt an annual accounting period described in paragraph (h) of this section. This section shall not apply, however, to:

(1) Any taxpayer to which the provisions of § 1.1502-76 apply (other than a taxpayer to which the provisions of paragraph (h) of this section apply);

(2) Any taxpayer to which the provisions of § 1.442-1(e) apply;

(3) Any taxpayer that wishes to change its annual accounting period to a calendar year (including a change under 26 CFR 18.1378-1(b)) or to a 52-53-week taxable year that ends with reference to the month of December (see, however, § 1.441-3T);

(4) Any partnership that wishes to change its annual accounting period under § 1.706-1(b)(1) to the same taxable year as that of all of its principal partners or to which all of its principal partners are concurrently changing;

(5) Any corporation seeking S status that wishes to change its annual accounting period under section 4.02 of Rev. Proc. 83-25, 1983-1 C.B. 689, to the