that in 1986 X has gross receipts of $15 million. For taxable year 1987, this section applies to X because in 1986, the period during which X was in existence, X has average annual gross receipts of more than $5 million.

Example (2). Y, a calendar year C corporation that is not a qualified personal service corporation, has gross receipts of $10 million, $9 million, and $4 million for taxable years 1984, 1985, and 1986, respectively. In taxable year 1986, X has average annual gross receipts for the 3-taxable-year period ending with 1986 of $7.67 million ($10 million + 9 million + 4 million ÷3). Thus, for taxable year 1987, this section applies and Y must change from the cash method for such year.

Example (3). Z, a C corporation which is not a qualified personal service corporation, has a 5% partnership interest in ZAB partnership, a calendar year cash method taxpayer. All other partners of ZAB partnership are individuals. Z corporation has average annual gross receipts of $100,000 for the 3-taxable-year period ending with 1986 (*i.e.*, 1984, 1985 and 1986). The ZAB partnership has average annual gross receipts of $6 million for the same 3-taxable-year period. Since ZAB fails to meet the $5,000,000 gross receipts test for 1986, this section applies to ZAB for its taxable year beginning January 1, 1987. Accordingly, ZAB must change from the cash method for its 1987 taxable year. The gross receipts of Z corporation are not relevant in determining whether ZAB is subject to this section.

Example (4). The facts are the same as in example (3), except that during the 1987 taxable year of ZAB, the Z corporation transfers its partnership interest in ZAB to an individual. Under paragraph (a)(1) of this section, ZAB is treated as a partnership with a C corporation as a partner. Thus, this section requires ZAB to change from the cash method effective for its taxable year 1987. If ZAB later desires to change its method of accounting to the cash method for its taxable year beginning January 1, 1988 (or later), ZAB must comply with all requirements of law, including sections 446(b), 446(e), and 481, to effect the change.

Example (5). X, a C corporation that is not a qualified personal service corporation, was formed on January 1, 1986, in a transaction described in section 351. In the transaction, A, an individual, contributed all of the assets and liabilities of B, a trade or business, to X, in return for the receipt of all the outstanding stock of X. Assume that in 1986 X has gross receipts of $4 million. In 1984 and 1985, the gross receipts of B, the trade or business, were $10 million and $7 million respectively. The gross receipts test is applied for the period during which X and its predecessor trade or business were in existence. X has average annual gross receipts for the 3-taxable-year period ending with 1986 of $7 million ($10 million + $7 million + $4 million÷3). Thus, for taxable year 1987, this section applies and X must change from the cash method for such year.

[T.D. 8143, 52 FR 22766, June 16, 1987, as amended by T.D. 8329, 56 FR 485, Jan. 7, 1991; T.D. 8514, 58 FR 68299, Dec. 27, 1993]

§ 1.448–2T Nonaccrual of certain amounts by service providers (temporary).

(a) *In general.* This section applies to taxpayers qualified to use a nonaccrual-experience method of accounting provided for in section 448(d)(5) with respect to amounts to be received for the performance of services. Except as otherwise provided in this section, a taxpayer is qualified to use a nonaccrual-experience method of accounting if the taxpayer uses an accrual method of accounting with respect to amounts to be received for the performance of services by the taxpayer and either—

(1) The services are in fields referred to in section 448(d)(2)(A) and as described in §1.448–1T(e)(4) (*i.e.*, health, law, engineering, architecture, accounting, actuarial science, performing arts, or consulting); or

(2) The taxpayer meets the $5 million annual gross receipts test of section 448(c) and §1.448–1T(f)(2) for all prior taxable years.

(b) *Nonaccrual-experience method; treatment as method of accounting.* Any taxpayer who satisfies the requirements of this section is not required to accrue any portion of amounts to be received from the performance of services that, on the basis of such person's experience, and to the extent determined under the computation or formula used by the taxpayer and allowed under this section, will not be collected. This nonaccrual of amounts to be received for the performance of services shall be treated as a method of accounting under the Code (a nonaccrual-experience method).

(c) *Method not available if interest charged on amounts due.* A nonaccrual-experience method of accounting may not be used with respect to amounts due for which interest is required to be paid or for which there is any penalty for failure to timely pay any amounts due. For this purpose, the taxpayer will be treated as charging interest or penalties for late payment if the contract

or agreement expressly provides for the charging of interest or penalties for late payment, regardless of the practice of the parties. If the contract or agreement does not expressly provide for the charging of interest or penalties for late payment, the determination of whether the taxpayer charges interest or penalties for late payment will be made based on all of the facts and circumstances of the transaction, and not merely on the characterization by the parties or the treatment of the transaction under state or local law. However, the offering of a discount for early payment of an amount due will not be regarded as the charging of interest or penalties for late payment under this section, if—

(1) The full amount due is otherwise accrued as gross income by the taxpayer at the time the services are provided; and

(2) The discount for early payment is treated as an adjustment to gross income in the year of payment, if payment is received within the time required for allowance of such discount. *See* paragraph (f) *Example 1* of this section for an example of this rule.

(d) *Method not available for certain receivables*—(1) *Amounts earned and recognized through the performance of services.* A nonaccrual-experience method of accounting may be used only with respect to amounts earned by the taxpayer and otherwise recognized in income (an account receivable) through the performance of services by such taxpayer. For example, a nonaccrual-experience method may not be used with respect to amounts owed to the taxpayer by reason of the taxpayer's activities with respect to lending money, selling goods, or acquiring accounts receivable or other rights to receive payment from other persons (including persons related to the taxpayer) regardless of whether those persons earned such amounts through the provision of services.

(2) *Special rule.* Except as otherwise provided, for purposes of this section, accounts receivable do not include amounts that are not billed (*e.g.*, for charitable or pro bono services) or amounts contractually not collectible (*e.g.*, amounts in excess of a fee schedule agreed to by contract). *See* paragraph (f) *Examples 2* and *3* of this section for examples of this rule.

(e) *Use of experience to estimate uncollectible amounts*—(1) *In general.* In determining the portion of any amount due which, on the basis of experience, will not be collected, the taxpayer may use one of four safe harbor nonaccrual-experience methods of accounting provided in paragraphs (e)(2) through (e)(5) of this section. Alternatively, the taxpayer may use any other nonaccrual-experience method ("alternative nonaccrual-experience method") that clearly reflects the taxpayer's nonaccrual-experience, subject to the requirements of paragraph (e)(6) of this section. The safe harbor nonaccrual-experience methods provided in paragraphs (e)(2) through (e)(5) of this section will be presumed to clearly reflect a taxpayer's nonaccrual-experience. For purposes of determining a taxpayer's nonaccrual-experience under any method provided in this paragraph (e), accounts receivable described in paragraphs (c) and (d) of this section are not taken into account. *See* paragraph (g) of this section for procedures to obtain automatic consent to change to one of the safe harbor nonaccrual experience methods or to an alternative nonaccrual-experience method.

(2) *Safe harbor 1: Six-year moving average method*—(i) *General rule.* A taxpayer may use a nonaccrual experience method under which the taxpayer determines the uncollectible amount (six-year moving average amount) by multiplying its accounts receivable balance at the end of the current year by a percentage (six-year moving average percentage). The six-year moving average percentage is computed by dividing—

(A) The total bad debts (with respect to accounts receivable) sustained throughout the period consisting of the taxable year and the five preceding taxable years (or, with the approval of the Commissioner, a shorter period), adjusted for recoveries of bad debts during such period; by

(B) The sum of the accounts receivable earned throughout the entire six (or fewer) taxable year period (*i.e.*, the total amount of sales resulting in accounts receivable). *See* paragraph (f)

Example 4 of this section for an example of this method.

(ii) *Period of less than six taxable years.* A period shorter than six taxable years generally will be appropriate only if the short period consists of consecutive taxable years and there is a change in the type of a substantial portion of the outstanding accounts receivable such that the risk of loss is substantially increased. A decline in the general economic conditions in the area, which substantially increases the risk of loss, is a relevant factor in determining whether a shorter period is appropriate. However, approval to use a shorter period will not be granted unless the taxpayer supplies specific evidence that the accounts receivable outstanding at the close of the taxable years for the shorter period requested are not comparable in nature and risk to accounts receivable outstanding at the close of the six taxable years. A substantial increase in a taxpayer's bad debt experience is not, by itself, sufficient to justify the use of a shorter period. If approval is granted to use a shorter period, the experience for the excluded taxable years shall not be used for any subsequent year. A request for approval to exclude the experience of a prior taxable year shall be made in accordance with the applicable procedures for requesting a letter ruling and shall include a statement of the reasons such experience should be excluded. A request will not be considered unless it is sent to the Commissioner at least 30 days before the close of the first taxable year for which such approval is requested.

(iii) *Special rule for new taxpayers.* In the case of any current taxable year that is preceded by less than 5 taxable years, paragraph (e)(2)(i) of this section shall be applied by using the experience of the current year and the actual number of preceding taxable years.

(3) *Safe harbor 2: Actual experience method*—(i) *Option A: Three-year moving average.* A taxpayer may use a nonaccrual-experience method under which the taxpayer determines the uncollectible amount (actual nonaccrual-experience amount) by multiplying its year-end accounts receivable balance by a percentage (three-year moving average nonaccrual-experience percentage) reflecting its actual nonaccrual experience with respect to its accounts receivable balance at the beginning of the current taxable year and the two immediately preceding taxable years. Under this safe harbor method, a taxpayer is allowed to increase its actual nonaccrual-experience amount by 5 percent (adjusted nonaccrual-experience amount). The taxpayer's three-year moving average nonaccrual-experience percentage, actual nonaccrual-experience amount, and adjusted nonaccrual-experience amount are determined according to the following steps:

(A) *STEP 1.* Track the receivables in the taxpayer's accounts receivable balance at the beginning of the current taxable year to determine the dollar amount of the accounts receivable actually determined to be uncollectible and charged off and not recovered or determined to be collectible by the date selected by the taxpayer (determination date) for the taxable year. The determination date may not be later than the earlier of the due date, including extensions, for filing the taxpayer's federal income tax return for that taxable year or the date on which the taxpayer timely files such return for that taxable year.

(B) *STEP 2.* Repeat STEP 1 for the taxpayer's accounts receivable balance at the beginning of each of the two immediately preceding taxable years.

(C) *STEP 3.* To determine the taxpayer's three-year moving average nonaccrual-experience percentage, divide the sum of the net uncollectible amounts from STEP 1 and STEP 2 by the sum of the accounts receivable balance at the beginning of the current taxable year and the accounts receivable balance at the beginning of each of the two preceding taxable years.

(D) *STEP 4.* Multiply the percentage computed in STEP 3 by the taxpayer's accounts receivable balance at the end of the current taxable year. The product is the taxpayer's actual nonaccrual-experience amount for the current taxable year.

(E) *STEP 5.* To determine the taxpayer's adjusted nonaccrual-experience amount, multiply the actual nonaccrual-experience amount from STEP 4 by 1.05. See paragraph (f) *Example 5* of

this section for an example of this method.

(ii) *Option B: Up to three-year moving average.* Alternatively, except as provided in paragraph (e)(3)(iii) of this section, in computing its adjusted nonaccrual-experience amount described in paragraph (e)(3)(i) of this section, a taxpayer may use: its current year nonaccrual-experience percentage for the first taxable year this method is used; a two-year moving average nonaccrual-experience percentage for the second taxable year this method is used; and a three-year moving average nonaccrual-experience percentage for the third, and each succeeding, taxable year this method is used. *See* paragraph (f) *Examples 6, 7,* and *8* of this section for examples of this method.

(iii) *Special rule for new taxpayers.* Any newly formed taxpayer that wants to use the safe harbor nonaccrual-experience method of accounting described in paragraph (e)(3)(ii) of this section in its first taxable year and does not have any accounts receivable upon formation will not be able to exclude any portion of its year-end accounts receivable from income for its first taxable year because the taxpayer does not have any accounts receivable on the first day of the taxable year to track. Therefore, the taxpayer must begin creating its three-year moving average in its second taxable year by tracking the accounts receivables as of the first day of its second taxable year.

(4) *Safe harbor 3: Modified Black Motor method*—(i) *In general.* A taxpayer may use a nonaccrual-experience method under which the taxpayer determines the uncollectible amount (modified Black Motor amount) by multiplying its accounts receivable balance at the end of the current taxable year by a percentage (Black Motor moving average percentage), and then reducing the resulting amount by the credit charges (accounts receivable) generated and written off during the current taxable year. The Black Motor moving average percentage is computed by dividing—

(A) The total bad debts sustained in the current taxable year and the five preceding taxable years (or, with the approval of the Commissioner, a shorter period), adjusted for recoveries of bad debts during such period; by

(B) The sum of accounts receivable at the end of the current taxable year and the five preceding (or fewer) taxable years. *See* paragraph (f) *Example 10* of this section for an example of this method.

(ii) *Period of less than six taxable years.* The rules of paragraph (e)(2)(ii) of this section (regarding periods of less than six taxable years) shall apply to taxpayers using the Modified Black Motor method.

(iii) *Special rules for new taxpayers.* In the case of any current taxable year that is preceded by less than 5 taxable years, paragraph (e)(4)(i) of this section shall be applied by using the experience of the current taxable year and the actual number of preceding taxable years.

(5) *Safe harbor 4: Modified six-year moving average method*—(i) *In general.* A taxpayer may use a nonaccrual-experience method under which the taxpayer determines the uncollectible amount (modified six-year moving average amount) by multiplying its accounts receivable balance at the end of the current year by a percentage (modified six-year moving average percentage). The modified six-year moving average percentage is computed by dividing—

(A) The total bad debts sustained in the current taxable year and the five preceding taxable years (or, with the approval of the Commissioner, a shorter period) other than the credit charges (accounts receivable) that were written off in the same taxable year they were generated, adjusted for recoveries of bad debts during such period; by

(B) The sum of accounts receivable at the end of the current taxable year and the five preceding (or fewer) taxable years. *See* paragraph (f) *Example 11* of this section for an example of this method.

(ii) *Period of less than six taxable years.* The rules of paragraph (e)(2)(ii) of this section (regarding periods of less than six taxable years) shall apply to taxpayers using the Modified six-year moving average method.

(iii) *Special rules for new taxpayers.* In the case of any current taxable year that is preceded by less than 5 taxable years, paragraph (e)(5)(i) of this section shall be applied by using the experience of the current taxable year and

the actual number of preceding taxable years.

(6) *Alternative nonaccrual-experience method*—(i) *In general.* A taxpayer may use any alternative nonaccrual-experience method that clearly reflects the taxpayer's actual nonaccrual-experience, provided the taxpayer's alternative nonaccrual-experience method meets the self-test requirements described in this paragraph (e)(6).

(ii) *Self-testing.* A taxpayer using, or desiring to use, an alternative nonaccrual-experience method must "self-test" its alternative nonaccrual-experience method for its first taxable year ending after March 9, 2002, for which the taxpayer uses, or desires to use, that alternative nonaccrual-experience method (first-year self-test), and every three taxable years thereafter (three-year self-test). Each self-test shall be performed by comparing the nonaccrual-experience amount under the taxpayer's alternative nonaccrual-experience method (alternative nonaccrual-experience amount) with the nonaccrual-experience amount that would have resulted from use of one safe harbor method described in paragraph (e)(2), (e)(3), (e)(4), or (e)(5) of this section selected by the taxpayer for use in conducting the self test (safe harbor comparison method), for the test period.

(iii) *Selection of safe harbor comparison method*—(A) *First-year self-test.* For purposes of conducting the first-year self-test required under paragraph (e)(6)(ii) of this section, a taxpayer may self-test its alternative nonaccrual-experience method against any safe harbor method provided in paragraphs (e)(2) through (e)(5) of this section. *See* paragraph (f) *Example 12* of this section for an example of this rule.

(B) *Three-year self-test.* For purposes of conducting any three-year self-test required under paragraph (e)(6)(ii) of this section, the taxpayer must self-test its alternative nonaccrual-experience method against the same safe harbor comparison method used for the immediately preceding self-test. For purposes of the three-year self-test, the cumulative nonaccrual-experience amount for the safe harbor comparison method is computed by using, for each taxable year of the test period, the same safe harbor comparison method used during the immediately preceding self test (cumulative safe harbor nonaccrual-experience amount). *See* paragraph (f) *Example 13* of this section for an example of this rule.

(C) *Change of safe harbor comparison method.* (*1*) A taxpayer that wants to change the safe harbor comparison method it uses for purposes of the self-testing requirement of paragraph (e)(6)(ii) of this section may do so only for the first taxable year following any three-year self-test period and in accordance with this paragraph (e)(6)(iii)(C). A change in the taxpayer's safe harbor comparison method is a change in method of accounting to which the procedures of sections 446 and 481, and the regulations thereunder, apply.

(*2*) For the taxable year a taxpayer wishes to change its safe harbor comparison method, the taxpayer must self-test its alternative nonaccrual-experience method against any safe harbor method provided in paragraphs (e)(2) through (e)(5) of this section other than the safe harbor comparison method currently used by the taxpayer and such self-test shall be conducted as if such self-test was a first-year self-test.

(*3*) If the self-test described in paragraph (e)(6)(iii)(C)(*2*) of this section results in the taxpayer's alternative nonaccrual-experience method clearly reflecting the taxpayer's nonaccrual-experience as determined under paragraph (e)(6)(iv) of this section, then the taxpayer may change its safe harbor comparison method in accordance with the procedures under paragraph (g)(3) of this section. Such change shall be made on a cut-off basis and without audit protection.

(*4*) If the self-test described in paragraph (e)(6)(iii)(C)(*2*) of this section results in the taxpayer's alternative nonaccrual-experience method not clearly reflecting the taxpayer's nonaccrual-experience as determined under paragraph (e)(6)(vi)(A) of this section, then the taxpayer cannot use the safe harbor comparison method selected and must either—

(*i*) Continue using its current safe harbor comparison method; or

(*ii*) Select another safe harbor comparison method, subject to the requirements of paragraphs (e)(6)(iii)(C)(*2*) and (*3*) of this section.

(*5*) If a taxpayer meets the requirements of this paragraph (e)(6)(iii)(C) to change its safe harbor comparison method, the new safe harbor comparison method is not used for purposes of conducting the three-year self-test required by paragraph (e)(6)(ii) of this section for the taxable year immediately preceding the taxable year the taxpayer is permitted to change its safe harbor comparison method. The taxpayer's former safe harbor comparison method is used for purposes of conducting such three-year self-test and for purposes of determining any recapture amount under paragraph (e)(6)(vi)(B) of this section.

(iv) *Treated as clearly reflecting nonaccrual-experience.* If the alternative nonaccrual-experience amount for the first-year self-test (or the cumulative nonaccrual-experience amount for the three-year self-test, as applicable) is less than or equal to the nonaccrual-experience amount determined under paragraph (e)(6)(iii)(A) of this section (first-year self-test) or the cumulative safe harbor nonaccrual-experience amount determined under paragraph (e)(6)(iii)(B) of this section (three-year self-test), as applicable, for the test period, then—

(A) The taxpayer's alternative nonaccrual-experience method will be treated as clearly reflecting its nonaccrual-experience for the test period; and

(B) The taxpayer may continue to use that alternative nonaccrual-experience method, subject to a requirement to self-test again after three taxable years.

(v) *Contemporaneous documentation.* For purposes of paragraph (e)(6) of this section, a taxpayer must document in its books and records, in the taxable year any first-year or three-year self-test is performed, the safe harbor comparison method used to conduct the self-test, including appropriate documentation and computations that resulted in the determination that the taxpayer's alternative nonaccrual-experience method clearly reflected the taxpayer's nonaccrual-experience for the applicable test period.

(vi) *Special rules for alternative nonaccrual-experience method.* (A) *First-year self-test.* If, as a result of the first-year self-test requirement of paragraph (e)(6)(ii) of this section, the alternative nonaccrual-experience amount for the test period is greater than the safe harbor nonaccrual-experience amount for the test period, then—

(*1*) The taxpayer's alternative nonaccrual-experience method will be treated as not clearly reflecting its nonaccrual-experience;

(*2*) The taxpayer will not be permitted to use that alternative nonaccrual-experience method in such taxable year; and

(*3*) The taxpayer must change to (or adopt) for such taxable year either—

(*i*) A safe harbor nonaccrual-experience method described in paragraphs (e)(2) through (e)(5) of this section; or

(*ii*) Another alternative nonaccrual-experience method, subject to the first-year self-test requirement of paragraph (e)(6)(ii) of this section. *See* paragraph (f) *Example 14* of this section for an example of this rule.

(B) *Three-year self-test.* If, as a result of the three-year self-test requirement of paragraph (e)(6)(ii) of this section, the cumulative alternative nonaccrual-experience amount for the test period is greater than the cumulative safe harbor nonaccrual-experience amount for the test period, the taxpayer's alternative nonaccrual-experience amount will be limited to the cumulative safe harbor nonaccrual-experience amount for the test period. Any excess of the taxpayer's cumulative alternative nonaccrual-experience amount over the taxpayer's cumulative safe harbor nonaccrual-experience amount excluded from income during the test period must be recaptured into income in accordance with paragraph (e)(6)(vii) of this section. The taxpayer may continue to use its alternative nonaccrual-experience method, subject to the three-year self-test requirement in paragraph (e)(6)(ii) of this section. *See* paragraph (f) *Example 15* of this section for an example of this rule.

(vii) *Recapture.* Any amount required to be recaptured pursuant to paragraph

(e)(6)(vi)(B) of this section must be included in income in the third taxable year of the three-year self-test period. *See* paragraph (f) *Example 15* of this section for an example of this rule.

(7) *Special rules*—(i) *Application to specific accounts receivable.* The nonaccrual-experience method shall be applied with respect to each account receivable of the taxpayer that is eligible for such method. With respect to a particular account receivable, the taxpayer will determine, in the manner prescribed in paragraphs (e)(2) through (e)(6) of this section (whichever applies), the amount of such account receivable that is not expected to be collected. Such determination shall be made only once with respect to each account receivable, regardless of the term of such receivable. The estimated uncollectible amount shall not be recognized as gross income. Thus, the amount recognized as gross income shall be the amount that would otherwise be recognized as gross income with respect to the account receivable, less the amount which is not expected to be collected. A taxpayer that excludes an amount from income during a taxable year as a result of the taxpayer's use of a nonaccrual-experience method cannot deduct in any subsequent taxable year the amount excluded from income. Thus, the taxpayer cannot deduct the excluded amount in a subsequent taxable year in which the taxpayer actually determines that the amount is uncollectible and charges it off. If a taxpayer using a nonaccrual-experience method determines that an amount that was not excluded from income is uncollectible and should be charged off (*e.g.*, a calendar-year taxpayer determines on November 1st that an account receivable that was originated on May 1st of the same year is uncollectible and should be charged off) the taxpayer may deduct the amount charged off when it is charged off, but must include any subsequent recoveries in income. The reasonableness of a taxpayer's determinations that amounts are uncollectible and should be charged off may be considered on examination. *See* paragraph (f) *Example 16* of this section for an example of this rule.

(ii) *Charge-off.* For purposes of this section, amounts charged-off shall include only those amounts that would otherwise be allowable under section 166(a).

(iii) *Recoveries.* Regardless of the nonaccrual-experience method of accounting used by a taxpayer under this section, the taxpayer must take into account recoveries of amounts previously charged off. If, in a subsequent taxable year, a taxpayer recovers an amount previously excluded from income under a nonaccrual-experience method or charged off, the taxpayer must include the recovered amount in income in that subsequent taxable year. *See* paragraph (f) *Example 17* of this section for an example of this rule.

(iv) *Application of nonaccrual-experience method.* The rules of section 448(d)(5) and the regulations thereunder shall be applied separately to each taxpayer. For purposes of section 448(d)(5), the term "taxpayer" has the same meaning as the term "person" defined in section 7701(a)(1) (rather than the meaning of the term "taxpayer" defined in section 7701(a)(14)).

(v) *Record keeping requirements.* (A) A taxpayer using a nonaccrual-experience method shall keep such books and records as are sufficient to establish the amount of any exclusion from gross income under section 448(d)(5) for the taxable year, including books and records demonstrating—

(*1*) The nature of the taxpayer's nonaccrual-experience method;

(*2*) Whether, for any particular taxable year, the taxpayer qualifies to use its nonaccrual-experience method (including the self-testing requirements of paragraph (e)(6)(ii) of this section (if applicable));

(*3*) The taxpayer's determination that amounts are uncollectible; and

(*4*) The proper amount that is excludable under the taxpayer's nonaccrual-experience method.

(B) A taxpayer that does not maintain records of the data that are sufficient to establish the amount of any exclusion from gross income under section 448(d)(5) for the taxable year may be subject to being changed by the IRS on examination to the specific charge-off method. See §1.6001–1 for rules regarding records.

(f) *Examples.* The following examples illustrate the provisions of this section. In each example, the taxpayer uses a calendar year for federal income tax purposes and an accrual method of accounting, does not require the payment of interest or penalties with respect to past due accounts receivable and, in the case of *Examples 5* through *8* and *12* through *15*, selects an appropriate determination date for each taxable year.

Example 1. Charging interest and/or penalties. A has two billing methods for the amounts to be received from A's provision of services described in paragraph (a)(1) of this section. Under one method, for amounts that are more than 90 days past due, A charges interest at a market rate until such amounts (together with interest) are paid. Under the other billing method, A charges no interest for amounts past due. Pursuant to paragraph (c) of this section, A may not use a nonaccrual-experience method of accounting with respect to any of the amounts billed under the method that charges interest on amounts that are more than 90 days past due. A may, however, use the nonaccrual-experience method with respect to the amounts billed under the method that does not charge interest for amounts past due.

Example 2. Contractual allowance or adjustment. B, a healthcare provider, performs a medical procedure on individual C, who has health insurance coverage with IC, an insurance company. B bills IC and C for $5,000, B's standard charge for this medical procedure. However, B has a contract with IC that obligates B to accept $3,500 as full payment for the medical procedure if the procedure is provided to a patient insured by IC. Under the contract, only $3,500 of the $5,000 billed by B is legally collectible from IC and C. The remaining $1,500 represents a contractual allowance or contractual adjustment. Thus, pursuant to paragraph (d)(2) of this section, the remaining $1,500 is not a contractually collectible amount for purposes of this section and B may not use a nonaccrual-experience method with respect to this portion of the accounts receivable.

Example 3. Charitable or pro bono services. D, a law firm, agrees to represent individual E in a legal matter and to provide services to E on a pro bono basis. D normally charges $500 for these services. Because D performed its services to E pro bono, D's services were never billed or intended to result in revenue. Thus, pursuant to paragraph (d)(2) of this section, the $500 forgone legal fee is not a collectible amount for purposes of this section and D may not use a nonaccrual-experience method with respect to this portion of the accounts receivable.

Example 4. Safe harbor 1: Six-year moving average method. (i) F uses the six-year moving average method described in paragraph (e)(2) of this section. F's total accounts receivable and bad debt experience for the current taxable year (2002) and the five preceding taxable years are as follows:

Taxable year	Total accounts receivable	Bad debts adjusted for recoveries
1997	$30,000	$5,700
1998	40,000	7,200
1999	40,000	11,000
2000	60,000	10,200
2001	70,000	14,000
2002	90,000	16,800
Total	$330,000	$64,900

(ii) Thus, F's six-year moving average percentage is 19.67% ($64,900/$330,000). Assume that $49,300 of the total $90,000 of accounts receivable earned throughout the taxable year 2002 is outstanding as of the close of that taxable year. F's nonaccrual-experience amount using the six-year moving average safe harbor method is computed by multiplying $49,300 by the six-year moving average percentage of .1967, or $9,697. Thus, F may exclude $9,697 from gross income for 2002.

Example 5. Safe harbor 2: Actual experience method (Option A). (i) G is eligible to use a nonaccrual-experience method and wishes to adopt the actual experience method of paragraph (e)(3)(i) of this section. G has the data necessary to track the uncollectible amounts in its beginning-of-year accounts receivable for the current taxable year and the two immediately preceding taxable years. G determines that its actual accounts receivable collection experience is as follows:

Taxable year	Total A/R balance at beginning of year	Beginning A/R amount charged off by determination date *(adjusted for recoveries)*
2000	$1,000,000	$35,000
2001	760,000	75,000
2002	1,975,000	65,000
Total	$3,735,000	$175,000

(ii) G's ending A/R Balance on 12/31/2002 is $880,000. In 2002, G chooses to compute its nonaccrual-experience amount by using the three-year moving average under Option A of paragraph (e)(3)(i) of this section. Thus, G's three-year moving average nonaccrual-experience percentage is 4.7%, determined by dividing the sum of the amount of G's receivables in its account on January 1st of 2000, 2001, and 2002, that were determined to be uncollectible and charged off (adjusted for recoveries) on or before the corresponding

determination dates, by the sum of the balances of G's accounts receivable account on January 1st of 2000, 2001, and 2002 (*i.e.*, $175,000/$3,735,000 or 4.7%). Thus, G's actual nonaccrual-experience amount for 2002 is determined by multiplying this percentage by the balance of G's accounts receivable account on December 31, 2002 (*i.e.*, $880,000 × 4.7% = $41,360). G is permitted to exclude from gross income in 2002 an amount equal to 105% of G's actual nonaccrual-experience amount, or $43,428 ($41,360 × 105%). This is G's adjusted nonaccrual-experience amount for 2002.

Example 6. Safe harbor 2: Actual experience method (Option B). The facts are the same as *Example 5,* except that G has not maintained the data necessary to use Option A of paragraph (e)(3)(i) of this section. G determines that, of its 2002 beginning-of-year receivables of $1,975,000, $65,000 were determined to be uncollectible and charged off (adjusted for recoveries) on or before September 15, 2003, the date G timely files its federal income tax return for 2002 (the determination date). G chooses to use Option B of paragraph (e)(3)(ii) of this section to compute its adjusted nonaccrual-experience amount for 2002. G's current year nonaccrual-experience percentage is 3.3%, determined by dividing the amount of G's receivables in its account on January 1, 2002, that were charged off as uncollectible (adjusted for recoveries) on or before the determination date, by the balance of G's accounts receivable account on January 1, 2002 (*i.e.*, $65,000/$1,975,000 or 3.3%). Thus, G's actual nonaccrual-experience amount for 2002 is determined by multiplying this percentage by the balance of G's accounts receivable account on December 31, 2002 (*i.e.*, $880,000 × 3.3% = $29,040). G is permitted to exclude from gross income in 2002 an amount equal to 105% of G's actual nonaccrual-experience amount, or $30,492 ($29,040 × 105%). This is G's adjusted nonaccrual-experience amount for 2002.

Example 7. (i) The facts are the same as *Example 6.* G determines that its accounts receivable collection experience for 2003 is as follows:

Taxable year	Total A/R balance at beginning of year	Beginning A/R amount charged off by determination date (adjusted for recoveries)
2002	$1,975,000	$65,000
2003	880,000	95,000
Total	$2,855,000	$160,000

(ii) G's ending A/R Balance on 12/31/2003 is $2,115,000. In 2003, G must compute its nonaccrual-experience amount using an average of its actual nonaccrual-experience for 2002 and 2003 (in accordance with Option B of paragraph (e)(3)(ii) of this section). Thus, G's two-year moving average nonaccrual-experience percentage is 5.6%, determined by dividing the sum of the amount of G's receivables in its accounts on January 1st of 2002 and 2003, that were determined to be uncollectible and charged off (adjusted for recoveries) on or before the corresponding determination dates, by the sum of the balances of G's accounts receivable account on January 1st of 2002 and 2003 (*i.e.*, $160,000/$2,855,000 or 5.6%). Thus, G's actual nonaccrual-experience amount for 2003 is determined by multiplying this percentage by the balance of G's accounts receivable account on December 31, 2003 (*i.e.*, $2,115,000 × 5.6% = $118,440). G is permitted to exclude from gross income in 2003 an amount equal to 105% of G's actual nonaccrual-experience amount, or $124,362 ($118,440 × 105%). This is G's adjusted nonaccrual-experience amount for 2003.

Example 8. (i) The facts are the same as *Example 7.* G determines that its accounts receivable collection experience for 2004 is as follows:

Taxable year	Total A/R balance at beginning of year	Beginning A/R amount charged off by determination date (adjusted for recoveries)
2002	$1,975,000	$65,000
2003	880,000	95,000
2004	2,115,000	105,000
Total	$4,970,000	$265,000

(ii) G's ending A/R Balance on 12/31/2004 is $1,600,000. In 2004, G must compute its nonaccrual-experience amount using an average of its actual nonaccrual-experience for 2002, 2003, and 2004 (in accordance with Option B of paragraph (e)(3)(ii) of this section). Thus, G's actual three-year moving average nonaccrual-experience percentage is 5.3%, determined by dividing the sum of the amount of G's receivables in its account on January 1st of 2002, 2003, and 2004, that were determined to be uncollectible and charged off (adjusted for recoveries) on or before the corresponding determination dates, by the sum of the balances of G's accounts receivable account on January 1st of 2002, 2003, and 2004 (*i.e.*, $265,000/$4,970,000 or 5.3%). Thus, G's actual nonaccrual-experience amount for 2004 is determined by multiplying this percentage by the balance of G's accounts receivable account on December 31, 2004 (*i.e.*, $1,600,000 × 5.3% = $84,800). G is permitted to exclude from gross income in 2004 an amount equal to 105% of G's actual nonaccrual-experience amount, or $89,040 ($84,800 × 105%). This is G's adjusted nonaccrual-experience amount for

2004. Thereafter, G must continue to use a three-year moving average to compute its actual nonaccrual-experience, or obtain approval of the Commissioner to change its nonaccrual-experience method of accounting.

Example 9. H has not tracked its 2002 beginning-of-year accounts receivable. Therefore, H may not use the actual experience method described in paragraph (e)(3) of this section for 2002. H may use this method for 2003 if H tracks its 2003 beginning-of-year receivables, and otherwisecomplies with the requirements of this section.

Example 10. Safe harbor 3: Modified Black Motor method. (i) J uses the modified Black Motor method described in paragraph (e)(4) of this section. J's total accounts receivable and bad debt experience for the current taxable year (2002) and the five preceding taxable years are as follows:

Taxable year	Accounts receivable at end of taxable year	Bad debts (adjusted for recoveries)
1997	$130,000	$9,100
1998	140,000	7,000
1999	140,000	14,000
2000	160,000	14,400
2001	170,000	20,400
2002	180,000	10,800
Total	$920,000	$75,700

(ii) Thus, J's Black Motor moving average percentage is 8.228% ($75,700/$920,000). Assume that the credit charges (accounts receivable) generated and written off during the current taxable year were $3,600. J's modified Black Motor amount is $11,210, computed by multiplying J's accounts receivable at December 31, 2002 ($180,000) by the Black Motor moving average percentage of .08228 and reducing the resulting amount by $3,600 (J's credit charges (accounts receivable) generated and written off during the 2002 taxable year). Thus, J may exclude $11,210 from gross income for 2002.

Example 11. Safe harbor 4: Modified six-year moving average method. (i) The facts are the same as *Example 10*, except that J uses the modified six-year moving average method described in paragraph (e)(5) of this section. Assume further that the credit charges (accounts receivable) that were written off in the same taxable year they were generated, adjusted for recoveries of bad debts during such period are as follows:

Taxable Year	Credit charges written off in same taxable year as generated (adjusted for recoveries)
1997	$3,033
1998	2,333
1999	4,667
2000	4,800
2001	6,800
2002	3,600
Total	$25,233

(ii) Thus, J's modified six-year moving average percentage is 5.486% (($75,700—$25,233)/$920,000). J's modified six-year moving average amount is $9,875, computed by multiplying J's accounts receivable at December 31, 2002 ($180,000) by the modified six-year moving average percentage of .05486. Thus, J may exclude $9,875 from gross income for 2002.

Example 12. Selection of a safe harbor method. (i) Beginning in 2002, K is eligible to use a nonaccrual-experience method and wishes to adopt an alternative nonaccrual-experience method similar to the method described in *Black Motor Co. v. Comm'r*, 41 B.T.A. 300 (1940), *aff'd*, 125 F.2d 977 (6th Cir. 1942). Pursuant to paragraph (e)(6)(ii) of this section, K must self-test its alternative nonaccrual-experience method for the first taxable year it is used (2002), and every three taxable years thereafter for which K uses its alternative nonaccrual-experience method. Pursuant to paragraph (e)(6)(iii) of this section, K selects safe harbor 2 (actual experience method) for purposes of conducting its first year self-test. Thus, beginning in 2002, K must begin tracking its beginning-of-year accounts receivable and computing its actual nonaccrual-experience as provided in paragraph (e)(3) of this section. However, because K lacks the data to use Option A (three-year moving average) under paragraph (e)(3)(i) of this section, K selects Option B (up to three-year moving average) under paragraph (e)(3)(ii) of this section. K's actual nonaccrual-experience amount and alternative nonaccrual-experience amount for 2002 are set forth below:

Taxable year	Total A/R balance at beginning of year	Beginning A/R amount charged off by determination date (adjusted for recoveries)	Alternative nonaccrual-experience amount
2002	$350,000	$14,000	$20,700

(ii) K's ending A/R Balance on 12/31/2002 is $500,000. K's actual nonaccrual-experience percentage is 4%, determined by dividing the amount of K's receivables in its account on January 1, 2002, that were charged off as uncollectible (adjusted for recoveries) on or before the determination date, by the balance of K's accounts receivable account on January 1, 2002 (*i.e.*, $14,000/$350,000 or 4%). Thus, K's actual nonaccrual-experience amount for 2002 is determined by multiplying this percentage by the balance of K's accounts receivable account on December 31, 2002 (*i.e.*, $500,000 × 4% = $20,000). Because K's alternative nonaccrual-experience amount for 2002 ($20,700) is not greater than 105% of its actual nonaccrual-experience amount for 2002 (*i.e.*, $20,000 × 1.05 = $21,000), pursuant to paragraph (e)(6)(iv) of this section, K's alternative nonaccrual-experience method will be treated as clearly reflecting its nonaccrual-experience for the test period 2002. Pursuant to paragraph (e)(6)(iv)(B) of this section, K may continue to use its alternative nonaccrual-experience method. Additionally, pursuant to paragraph (e)(6)(iv)(B) of this section, K is required to self-test its alternative nonaccrual-experience method again in 2006, for taxable years 2003 through 2005 and, pursuant to paragraph (e)(6)(iii)(B) of this section, K must self-test its alternative nonaccrual-experience method against the actual experience method when conducting its three year self-test in 2006.

Example 13. (i) The facts are the same as *Example 12.* K's alternative nonaccrual-experience amounts for taxable years 2003–2005 are as follows:

Taxable Year	Total A/R balance at beginning of year	Beginning A/R amount charged off by determination date (adjusted for recoveries)	Actual nonaccrual-experience amount	Alternative nonaccrual-experience amount
2003	$440,000	$30,000	$42,329	$43,050
2004	760,000	65,000	138,183	140,200
2005	1,965,000	65,000	101,106	110,550
Total	$3,165,000	$160,000	$281,618	$293,800

(ii) Assume that K's ending A/R balance on 12/31/05 is $2,000,000. Because K's cumulative alternative nonaccrual-experience amount for the test period ($293,800) is not greater than K's cumulative adjusted nonaccrual-experience amount (cumulative actual nonaccrual-experience amount × 105%) for the same period ($281,618 × 1.05 = $295,699), pursuant to paragraph (e)(6)(iv) of this section K's alternative nonaccrual-experience method will be treated as clearly reflecting its nonaccrual-experience for the test period. Pursuant to paragraph (e)(6)(iv)(B) of this section, K may continue to use its alternative nonaccrual-experience method. Additionally, pursuant to paragraph (e)(6)(iv)(B) of this section, K is required to self-test its alternative nonaccrual-experience method again in 2009, for taxable years 2006 through 2008 and, pursuant to paragraph (e)(6)(iii)(B) of this section, K must self-test its alternative nonaccrual-experience method against the actual experience method when conducting its three year self-test in 2009.

Example 14. The facts are the same as *Example 12,* except that K's alternative nonaccrual-experience amount for 2002 is $22,000. Because K's alternative nonaccrual-experience amount for 2002 ($22,000) is greater than 105% of its actual nonaccrual-experience amount for 2002 (*i.e.*, $20,000 × 1.05 = $21,000), pursuant to paragraph (e)(6)(vi)(A) of this section, K's alternative nonaccrual-experience method will be treated as not clearly reflecting its nonaccrual experience for 2002. Accordingly, K must either adopt a safe harbor nonaccrual-experience method described in paragraphs (e)(2) (six-year moving average method), (e)(3) (actual experience method), (e)(4) (modified Black Motor method), or (e)(5) (modified six-year moving average method) of this section, or an alternative nonaccrual-experience method under paragraph (e)(6) of this section (subject to the

self-testing requirements of paragraph (e)(6)(ii) of this section).

Example 15. The facts are the same as *Example 13,* except that K's cumulative alternative nonaccrual-experience amount for 2003–2005 is $300,000. Because K's cumulative alternative nonaccrual-experience amount for the three-year test period (taxable years 2003–2005) is greater than its cumulative adjusted nonaccrual-experience amount for the three-year test period ($295,699), pursuant to paragraph (e)(6)(vi)(B) of this section the $4,301 excess of K's cumulative alternative nonaccrual-experience amount over K's cumulative adjusted nonaccrual-experience amount for the three year test period must be recaptured into income in 2005 in accordance with paragraph (e)(6)(vii) of this section. K may continue to use its alternative nonaccrual-experience method, subject to the three-year self-test requirement in paragraph (e)(6)(ii) of this section.

Example 16. Subsequent worthlessness of year-end receivable. The facts are the same as *Example 4.* Assume that one of the accounts receivable outstanding at the end of 2002 was for $8,000, and that in 2003, under section 166, the entire amount of this receivable becomes wholly worthless. Because F did not accrue as income $1,573 of this account receivable ($8,000 × .1967) under the nonaccrual-experience method in 2002, pursuant to paragraph (e)(7)(i) of this section F may not deduct this portion of the account receivable as a bad debt deduction under section 166 in 2003. F may deduct the remaining balance of the receivable in 2003 as a bad debt deduction under section 166 ($8,000 − $1,574 = $6,426).

Example 17. Subsequent collection of year-end receivable. The facts are the same as in *Example 4.* Assume that an account receivable of $1,700 outstanding at the end of 2002 was collected in full by F in 2003. Pursuant to paragraph (e)(7)(iii) of this section, F must recognize additional gross income in 2003 equal to the portion of this receivable that F excluded from gross income in the prior year ($1,700 × .1967 = $334).

(g) *Changes to a nonaccrual-experience method of accounting*—(1) *In general.* A change to a nonaccrual-experience method is a change in method of accounting to which the provisions of sections 446 and 481, and the regulations thereunder, apply.

(2) *Taxpayers no longer qualified under section 448 to use a nonaccrual-experience method*—(i) *First taxable year ending after March 9, 2002.* For a taxpayer who no longer qualifies under section 448(d)(5), as amended, to use a nonaccrual-experience method, consent is hereby granted to change from the nonaccrual-experience method to the specific charge-off method for its first taxable year ending after March 9, 2002. Such change shall be made in accordance with the provisions of this paragraph (g)(2). Pursuant to the consent granted by this paragraph (g)(2), a taxpayer described in this paragraph (g)(2) that is using a nonaccrual experience method must change such method of accounting to the specific charge-off method for its first taxable year ending after March 9, 2002. The net amount of the required section 481(a) adjustment is to be taken into account over a period of 4 taxable years (or, if less, the number of taxable years that the taxpayer has used the nonaccrual-experience method). The taxpayer should attach Form 3115 to its income tax return for the year of change, and write "Change from the Nonaccrual-Experience Method under §1.448–2T(g)" at the top of the form. However, such a taxpayer is not required to file a Form 3115 with the national office, or pay any associated user fee.

(ii) *For taxable years subsequent to first taxable year ending after March 9, 2002.* Taxpayers who no longer qualify under section 448(d)(5), as amended, to use a nonaccrual-experience method in a taxable year subsequent to the first taxable year ending after March 9, 2002, must follow the administrative procedures issued under §1.446–1(e)(3)(ii) for obtaining the Commissioner's automatic consent to a change in accounting method. (For further guidance, for example, *see* Rev. Proc. 2002–9, 2002–1 C.B. 327, and §601.601(d)(2)(ii)*(b)* of this chapter.)

(3) *Taxpayers permitted to use a nonaccrual-experience method*—(i) *In general.* Except as provided in paragraphs (g)(3)(ii) (regarding scope limitations) and (g)(4) (regarding certain concurrent changes) of this section, a taxpayer that wants to change to a nonaccrual-experience method provided in this section, change from one nonaccrual-experience method to another nonaccrual-experience method provided in this section, and/or change to a periodic system (for further guidance, for example, *see* Notice 88–51, 1988–1 C.B. 535, and §601.601(d)(2)(ii)(*b*) of this chapter), must follow the administrative procedures issued under §1.446–1(e)(3)(ii) for

obtaining the Commissioner's automatic consent to a change in accounting method (for further guidance, for example, *see* Rev. Proc. 2002–9, 2002–1 C.B. 327, and §601.601(d)(2)(ii)(*b*) of this chapter).

(ii) *Scope limitations.* Any limitations on obtaining the automatic consent of the Commissioner do not apply to a taxpayer that wants to change to a nonaccrual-experience method of accounting provided in this section, and/or change to a periodic system (for further guidance, for example, see Notice 88–51, 1988–1 C.B. 535, and §601.601(d)(2)(ii)(*b*) of this chapter), for either its first or second taxable year ending after March 9, 2002, provided the taxpayer's nonaccrual-experience method of accounting is not an issue under consideration for taxable years under examination at the time the Form 3115 is filed with the national office. A taxpayer's nonaccrual-experience method of accounting is an issue under consideration for the taxable years under examination if the taxpayer receives written notification (for example, by examination plan, information document request (IDR), or notification of proposed adjustments or income tax examination changes) from the examining agent(s) specifically citing the treatment of the nonaccrual-experience method of accounting as an issue under consideration.

(iii) *Form 3115 must be completed.* When filing the Form 3115, the taxpayer must complete all applicable parts of the form and write "Automatic Change to Nonaccrual-Experience Method" at the top of the form.

(4) *Certain concurrent changes*—(i) *Taxpayers concurrently changing to an accrual method of accounting*—(A) *Automatic consent.* Taxpayers that want to change to a nonaccrual-experience method of accounting for the same taxable year for which they are required to change to an accrual method of accounting under section 448 and the regulations thereunder may concurrently change their method of accounting to a nonaccrual-experience method (with or without also changing to a periodic system (for further guidance, for example, see Notice 88–51, 1988–1 C.B. 535, and §601.601(d)(2)(ii)(*b*) of this chapter)), under this paragraph (g)(4)(i) with automatic consent of the Commissioner if they otherwise qualify under this section to use a nonaccrual-experience method of accounting. Taxpayers changing to a nonaccrual-experience method under this paragraph (g)(4)(i) must comply with the provisions of §1.448–1(h)(2). Moreover, such taxpayers must type or legibly print the following statement at the top of page 1 of Form 3115, "Automatic Change to Nonaccrual-ExperienceMethod and Overall Accrual Method." The consent of the Commissioner to change to a nonaccrual experience method is granted to taxpayers changing to such method under this paragraph (g)(4)(i).

(B) *Section 481(a) adjustment.* In the case of a taxpayer changing to a nonaccrual-experience method under this paragraph (g)(4)(i), the section 481(a) adjustment resulting from the change to a nonaccrual-experience method of accounting will be combined or netted with the net section 481(a) adjustment resulting from the change under §1.448–1(h)(2), and the resulting net section 481(a) adjustment will be taken into account over the section 481(a) adjustment period as determined under the applicable administrative procedures issued under §1.446–1(e)(3)(ii) for obtaining the Commissioner's consent to a change in accounting method.

(ii) *Taxpayers concurrently changing to a permissible special method*—(A) *Prior consent.* A taxpayer required to change to an accrual method of accounting under section 448 and the regulations thereunder that, as part of such change, also wants to change to a nonaccrual experience method of accounting and a permissible special method of accounting under §1.448–1(h)(3), may concurrently change its method of accounting to a nonaccrual-experience method of accounting (with or without also changing to a periodic system (for further guidance, for example, see Notice 88–51, 1988–1 C.B. 535, and §601.601(d)(2)(ii)(*b*) of this chapter)), under this paragraph (g)(4)(ii) with the prior consent of the Commissioner if the taxpayer otherwise qualifies under this section to use a nonaccrual-experience method of accounting. Taxpayers changing to a nonaccrual-experience method under this paragraph (g)(4)(ii) must comply with the provisions of

§1.448–1(h)(3). Moreover, such taxpayers must type or legibly print the following statement at the top of page 1 of Form 3115, "Change to Nonaccrual-Experience Method and SpecialMethod of Accounting—Section 448."

(B) *Section 481(a) adjustment.* The section 481(a) adjustment resulting from a change in method of accounting described under this paragraph (g)(4)(ii) must be taken into account in accordance with the rules provided in paragraph (g)(4)(i)(B) of this section.

(h) *Transition rules*—(1) *In general.* If a taxpayer adopted or changed to a nonaccrual-experience method of accounting in accordance with the provisions of Notice 2003–12 for any taxable year ending after March 9, 2002, and, on or before October 20, 2003, and for such taxable year the taxpayer would like to change to a different nonaccrual-experience method of accounting as provided in paragraphs (e)(2) through (e)(6) of this section, and/or change to a periodic system (for further guidance, for example, see Notice 88–51, 1988–1 C.B. 535, and §601.601(d)(2)(ii)(*b*) of this chapter), the taxpayer must follow the administrative procedures issued under §1.446–1(e)(3)(ii) for obtaining the Commissioner's automatic consent to a change in accounting method (for further guidance, for example, see Rev. Proc. 2002–9, 2002–1 C.B.327, and §601.601(d)(2)(ii)(*b*) of this chapter) and must file the original Form 3115 either—

(i) With an amended federal income tax return (or a qualified amended return under Rev. Proc. 94–69, 1994–2 C.B. 804, if applicable; hereinafter, referred to in this section as a "qualified amended return") on or before December 31, 2003, for the taxpayer's first taxable year ending after March 9, 2002, and any affected subsequent taxable year, and include the statement "Filed Pursuant to §1.448–2T(h)(1)(i)" at the top of any amended federal income tax return (or qualified amended return);

(ii) With the taxpayer's timely filed federal income tax return for the second taxable year ending after March 9, 2002, if this return has not been filed on or before September 4, 2003; or

(iii) If the taxpayer's federal income tax return for the second taxable year ending after March 9, 2002, was filed on or before September 4, 2003, with an amended federal income tax return (or a qualified amended return) on or before December 31, 2003, for the second taxable year ending after March 9, 2002, and include the statement "Filed Pursuant to §1.448–2T(h)(1)(iii)" at the top of the amended federal income tax return (or qualified amended return).

(2) *Pending Form 3115.* If a taxpayer filed a Form 3115 under the applicable administrative procedures with the national office to make a change in its method of accounting under section 448(d)(5), as amended, for a year of change for which this regulation is effective and the application or ruling request is pending with the national office on September 4, 2003, the taxpayer must notify the national office in writing prior to November 3, 2003, if the taxpayer wants to withdraw its Form 3115 under such administrative procedures. If the taxpayer notifies the national office within the time provided in this paragraph (h)(2), the taxpayer's Form 3115, and any user fee that was submitted with the Form 3115, will be returned to the taxpayer. A taxpayer whose Form 3115 is returned under this paragraph (h)(2) may file a new Form 3115 under the provisions prescribed in paragraphs (g) and (h) of this section. If the taxpayer does not notify the national office within the time provided in this paragraph (h)(2), the national office will continue to process the taxpayer's Form 3115 in accordance with the administrative procedures under which it was originally filed.

(i) [Reserved]

(j) *Audit protection.* If a taxpayer uses one of the nonaccrual-experience methods of accounting described in paragraphs (e)(3) (actual experience method), (e) (4) (modified Black Motor method), or (e)(5) (modified six-year moving average method) of this section to determine its amount excluded from gross income under section 448(d)(5), as amended, the taxpayer's use of that method will not be raised as an issue by the IRS in a taxable year that ends before September 4, 2003. If the taxpayer uses one of the nonaccrual-experience methods of accounting described in paragraphs (e)(3), (e)(4), or (e)(5) of this section, and its use of such method

is an issue under consideration in examination (as defined in paragraph (g)(3)(ii) of this section), in appeals, or before the U.S. Tax Court in a taxable year that ends before September 4, 2003, that issue will not be further pursued by the IRS.

(k) *Effective date.* This section is applicable for taxable years ending after March 9, 2002. The applicability of this section expires on or before September 5, 2006.

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TAXABLE YEAR FOR WHICH ITEMS OF GROSS INCOME INCLUDED

§ 1.451–1 General rule for taxable year of inclusion.

(a) *General rule.* Gains, profits, and income are to be included in gross income for the taxable year in which they are actually or constructively received by the taxpayer unless includible for a different year in accordance with the taxpayer's method of accounting. Under an accrual method of accounting, income is includible in gross income when all the events have occurred which fix the right to receive such income and the amount thereof can be determined with reasonable accuracy. Therefore, under such a method of accounting if, in the case of compensation for services, no determination can be made as to the right to such compensation or the amount thereof until the services are completed, the amount of compensation is ordinarily income for the taxable year in which the determination can be made. Under the cash receipts and disbursements method of accounting, such an amount is includible in gross income when actually or constructively received. Where an amount of income is properly accrued on the basis of a reasonable estimate and the exact amount is subsequently determined, the difference, if any, shall be taken into account for the taxable year in which such determination is made. To the extent that income is attributable to the recovery of bad debts for accounts charged off in prior years, it is includible in the year of recovery in accordance with the taxpayer's method of accounting, regardless of the date when the amounts were charged off. For treatment of bad debts and bad debt recoveries, see sections 166 and 111 and the regulations thereunder. For rules relating to the treatment of amounts received in crop shares, see section 61 and the regulations thereunder. For the year in which a partner must include his distributive share of partnership income, see section 706(a) and paragraph (a) of §1.706–1. If a taxpayer ascertains that an item should have been included in gross income in a prior taxable year, he should, if within the period of limitation, file an amended return and pay any additional tax due. Similarly, if a taxpayer ascertains that an item was improperly included in gross income in a prior taxable year, he should, if within the period of limitation, file claim for credit or refund of any overpayment of tax arising therefrom.

(b) *Special rule in case of death.* (1) A taxpayer's taxable year ends on the date of his death. See section 443(a)(2) and paragraph (a)(2) of §1.443–1. In computing taxable income for such year, there shall be included only amounts properly includible under the method of accounting used by the taxpayer. However, if the taxpayer used an accrual method of accounting, amounts accrued only by reason of his death shall not be included in computing taxable income for such year. If the taxpayer uses no regular accounting method, only amounts actually or constructively received during such year shall be included. (For rules relating to the inclusion of partnership income in the return of a decedent partner, see subchapter K, chapter 1 of the Code, and the regulations thereunder.)

(2) If the decedent owned an installment obligation the income from which was taxable to him under section 453, no income is required to be reported in the return of the decedent by reason of the transmission at death of such obligation. See section 453(d)(3). For the treatment of installment obligations acquired by the decedent's estate or by any person by bequest, devise, or inheritance from the decedent, see section 691(a)(4) and the regulations thereunder.