Amprolium in Grams per Ton	Indications for Use	Limitations	Sponsor
(i) 113.5 to 11, 350; to provide 5 milligrams (mg) per kilogram of body weight per day.	Calves: As an aid in the prevention of coccidiosis caused by *Eimeria bovis* and *E. zurnii*.	Top-dress on or mix in the daily ration. Feed for 21 days during periods of exposure or when experience indicates that coccidiosis is likely to be a hazard; as sole source of amprolium. Withdraw 24 hours before slaughter. A withdrawal period has not been established for this product in preruminating calves. Do not use in calves to be processed for veal.	050604
(ii) 113.5 to 11, 350; to provide 10 mg per kilogram of body weight per day.	Calves: As an aid in the treatment of coccidiosis caused by *Eimeria bovis* and *E. zurnii*.	Top-dress on or mix in the daily ration. Feed for 5 days; as sole source of amprolium. Withdraw 24 hours before slaughter. A withdrawal period has not been established for this product in preruminating calves. Do not use in calves to be processed for veal. For a satisfactory diagnosis, a microscopic examination of the feces should be done by a veterinarian or diagnostic laboratory before treatment; when treating outbreaks, the drug should be administered promptly after diagnosis is determined.	050604

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Dated: August 22, 2006.

Steven D. Vaughn,

Office of New Animal Drug Evaluation, Center for Veterinary Medicine.

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DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Parts 1 and 602

[TD 9285]

RIN 1545–BB43

Nonaccrual-Experience Method of Accounting Under Section 448(d)(5)

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to the use of a nonaccrual-experience method of accounting by taxpayers using an accrual method of accounting and performing services. The final regulations reflect amendments under the Job Creation and Worker Assistance Act of 2002. The final regulations affect qualifying taxpayers that want to adopt, change to, or change a nonaccrual-experience method of accounting under section 448(d)(5) of the Internal Revenue Code (Code).

DATES: *Effective Date:* These regulations are effective September 6, 2006.

Applicability Date: These regulations are applicable for taxable years ending on or after August 31, 2006.

Comment Date: Written comments must be received by January 4, 2007. These regulations require that a taxpayer's nonaccrual-experience method must be self-tested against the taxpayer's actual experience to determine whether the nonaccrual-experience method clearly reflects the taxpayer's experience. The determination of actual experience is reserved in these regulations. Comments are requested concerning how to determine actual experience for purposes of timely performing self-testing. Send submissions to: CC:PA:LPD:PR (REG–141402–02), Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Taxpayers also may submit comments electronically to the IRS internet site at *http://www.irs.gov/regs.*

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, W. Thomas McElroy, Jr., (202) 622–4970; concerning submission of comments, Kelly Banks, (202) 622–0392 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in these final regulations has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)) under control number 1545–1855.

The collection of information in these final regulations is in § 1.448–2(d)(8) and (e)(5). This information is required to enable the IRS to verify that a taxpayer is reporting the correct amount of income or gain or claiming the correct amount of losses, deductions, or credits from the taxpayer's use of the nonaccrual-experience method of accounting. The collection of information is required to obtain a benefit.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid control number.

The estimated annual burden per respondent is 3 hours.

Comments concerning the accuracy of this burden estimate and suggestions for reducing this burden should be sent to the Internal Revenue Service, Attn: IRS Reports Clearance Officer, SE:W:CAR:MP:T:T:SP, Washington, DC 20224, and to the Office of Management and Budget, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503.

Books and records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information

are confidential, as required by 26 U.S.C. 6103.

Background

This document contains amendments to the Income Tax Regulations (26 CFR part 1) under section 448(d)(5). Section 448(d)(5) was enacted by section 801 of the Tax Reform Act of 1986 (Pub. L. 99–514, 100 Stat. 2085) and was amended by section 403 of the Job Creation and Worker Assistance Act of 2002 (Pub. L. 107–147, 116 Stat. 21) (JCWA), effective for taxable years ending after March 9, 2002. On September 4, 2003, the IRS and Treasury Department published in the **Federal Register** (68 FR 52543) proposed amendments to the regulations under section 448(d) by cross-reference to temporary regulations (REG–141402–02) and temporary regulations (68 FR 52496) (TD 9090) (collectively, the 2003 regulations) relating to the limitation on the use of the nonaccrual-experience method of accounting under section 448(d)(5). A public hearing was held on December 10, 2003. Written and electronic comments responding to the proposed regulations were received. After consideration of all of the comments, the proposed regulations are adopted as revised by this Treasury decision, and the corresponding temporary regulations are removed. The revisions are discussed below.

Explanation of Provisions and Revisions and Summary of Comments

1. Overview

These final regulations generally follow the rules in the 2003 regulations. The final regulations include the four safe harbor nonaccrual-experience methods provided in the 2003 regulations, but those methods have been modified to provide more flexibility. Unlike the 2003 regulations, the final regulations do not require as a general rule that a taxpayer's nonaccrual-experience method be tested against one of the safe harbor nonaccrual-experience methods. Instead, the final regulations adopt, with modifications, the general rule from the 2003 regulations as a fifth safe harbor. The final regulations also adopt a new general rule that requires a taxpayer's nonaccrual-experience method be tested against actual experience unless the taxpayer has adopted one of the five safe harbor methods. These final regulations apply to taxable years ending on or after August 31, 2006.

Certain portions of the 2003 regulations have been removed or incorporated into other paragraphs of the final regulations. Section 1.448–2T(d) regarding certain receivables for which the nonaccrual-experience method is not allowed has been combined with § 1.448–2(c) in the final regulations. Special rules in various parts of the 2003 regulations such as § 1.448–2T(e)(2)(ii) and (iii), 1.448–2T(e)(3)(iii), 1.448–2T(e)(4)(ii) and (iii), and 1.448–2T(e)(5)(ii) and (iii), have been combined with the special rules in § 1.448–2T(e)(7) and are now in § 1.448–2(b), (c), and (d) of the final regulations. Most of § 1.448–2T(g), (h), and (j) of the 2003 regulations relating to methods of accounting and audit protection have been removed. The IRS and Treasury Department intend to issue administrative guidance that will contain procedures for certain changes in a nonaccrual-experience method of accounting. The general rule that a nonaccrual-experience method is a method of accounting to which sections 446 and 481 apply has been moved to § 1.448–2(b).

Other portions of the 2003 regulations have been moved to a new definitions and special rules paragraph in § 1.448–2(c) of the final regulations. Section 1.448–2T(d) regarding accounts receivable is included in a definition of accounts receivable in § 1.448–2(c)(1) of the final regulations. Other terms in the definitions paragraph include applicable period, bad debts, charge-offs, determination date, recoveries, and uncollectible amount. The final regulations incorporate these definitions, as appropriate, throughout. For example, in the 2003 regulations the four safe harbor methods include bad debts in the numerator; however, safe harbor 2 did not refer to bad debts, but instead described them as ''accounts receivable actually determined to be uncollectible and charged off * * *'' These descriptions should not be interpreted differently. Therefore, the final regulations use the defined term *bad debts* in each numerator. Finally, the examples are changed to conform to other changes within the final regulations.

2. Self-Testing Requirement

The 2003 regulations provide that a taxpayer may use any nonaccrual-experience method of accounting, provided the taxpayer's method meets the self-test requirements. The self-testing in the 2003 regulations requires a taxpayer to compare its proposed nonaccrual-experience method with one of the four safe harbor methods to determine whether the taxpayer's proposed method clearly reflects experience. Self-testing is required in the first taxable year to determine whether the proposed method is allowed (first-year self-testing requirement) and, if allowed, self-testing is required every three taxable years thereafter (three-year self-testing requirement). The final regulations provide, as a general rule, that a taxpayer may use any nonaccrual-experience method of accounting that clearly reflects the taxpayer's experience. The final regulations provide that taxpayers must self-test against the taxpayer's actual experience to determine whether a method clearly reflects the taxpayer's experience unless the taxpayer has adopted one of the five safe harbor methods. The final regulations reserve on the definition of actual experience.

a. Appropriateness of Self-Testing Requirement

Many commentators suggested that taxpayers should not be required to incur additional expenses to develop a separate system for performing the self-test, noting that it would be burdensome and impractical for the majority of taxpayers using an alternative nonaccrual-experience method to conduct the self-test due to the limitations of their existing automated recordkeeping systems. One commentator suggested that the self-test was outside the scope of the JCWA and legislative intent. These commentators all recommended that the final regulations omit the self-testing requirement.

The JCWA provides that ''[a] taxpayer may adopt, or * * * change to, a computation or formula that clearly reflects the taxpayer's experience,'' and that ''[a] request [to change] shall be approved if such computation or formula clearly reflects the taxpayer's experience.'' Public Law 107–147, section 403(a). Taxpayers and the IRS must be able to determine whether a nonaccrual-experience method clearly reflects the taxpayer's experience. The Secretary has broad authority to determine whether a method of accounting clearly reflects the taxpayer's income. A self-testing requirement is consistent with the statute, because it is the manner by which taxpayers and the IRS determine whether a nonaccrual-experience method clearly reflects the taxpayer's experience, and thus, clearly reflects the taxpayer's income. Taxpayers must be able to show that a nonaccrual-experience method clearly reflects experience prior to adopting or changing to the method. The requirement to self-test provides an objective standard for making the determination. Therefore, the final regulations do not adopt the

recommendation to omit a self-testing requirement and retain the rule that a taxpayer must maintain books and records sufficient to prove that the taxpayer's nonaccrual-experience method clearly reflects its experience for the taxable year of the exclusion.

b. Standard for Comparison

Commentators stated that the self-testing requirements do not allow taxpayers the opportunity to demonstrate that a proposed method clearly reflects their experience, because under the 2003 regulations all methods must be compared to one of the safe harbors. The commentators stated that none of the safe harbors reflect actual experience, because all of the safe harbors are moving averages rather than a comparison of the estimated uncollectible amount for a taxable year under the taxpayer's nonaccrual-experience method to the actual collection experience of that taxable year's accounts receivable. Thus, the commentators stated, the safe harbors may or may not reflect actual experience as well as the proposed method.

The final regulations modify the self-testing requirements in response to these comments and eliminate the requirement in the 2003 regulations that a taxpayer's nonaccrual-experience method must be tested against one of the four safe harbor methods. The final regulations require that the taxpayer's nonaccrual-experience method must be tested against the taxpayer's actual experience, unless the taxpayer is using one of the safe harbor nonaccrual-experience methods, which are deemed to clearly reflect experience.

For taxpayers and the IRS to implement and administer the nonaccrual-experience method, the determination of actual experience is necessary. Although commentators stated that taxpayers should be allowed to use hindsight and that actual experience would require the use of data reflecting the portion of the subject accounts receivable that remain uncollectible, the commentators did not elaborate regarding what ''remain uncollectible'' means, nor did the commentators set the date at which accounts receivable ''remain uncollectible.'' The determination and proof of actual experience generally is a simple matter for taxpayers whose collection process with respect to the subject receivables is complete by the time the Federal income tax return is filed. The collection cycle for some taxpayers, however, may routinely span several taxable years. The commentators did not elaborate how such a factual determination could be made prior to filing the Federal income tax return for the applicable taxable year (or alternatively, prior to filing the method change request for the applicable taxable year) in cases in which a taxpayer's collection cycle for the receivables goes beyond the date for the filing of the return (or method change). For taxpayers with a longer collection process, the determination of the final actual experience is not possible by the time the Federal income tax return is filed, and may continue to be incomplete upon examination by the IRS, if the taxpayer's collection process with respect to receivables is still in process. Additionally, it is possible that accounts receivable written off in one taxable year may be recovered several taxable years later, even for taxpayers whose average collection cycle is short. Therefore, the final regulations reserve the determination of actual experience.

The IRS and Treasury Department anticipate providing future guidance that may change or restrict the rules for self-testing and may address the determination of actual experience. In the meantime, taxpayers may request advance consent to use a method other than a safe harbor method, but in the request taxpayers must establish to the satisfaction of the Commissioner how the determination of actual experience is made. Comments are requested concerning how to determine actual experience. Specifically, the IRS and Treasury Department seek comments on how the use of hindsight data can be made administrable. For example, how will the IRS National Office have the necessary data furnished with the application for change in method of accounting, and how will the taxpayer be able to timely perform the self-testing? In particular, should one, fixed determination date be used as a cut-off for all information included in the determination of actual experience? What facts and circumstances, known by the filing deadline for a change in method of accounting and the filing deadline for an original Federal income tax return, can a taxpayer and the IRS rely on to determine the taxpayer's actual experience for purposes of the first-year self-testing requirements for the application for change in method of accounting and for purposes of the three-year self-testing requirements for the filing of the Federal income tax return? For a taxpayer that is applying to adopt or change to a nonaccrual-experience method of accounting, should the taxpayer be allowed to rely on the results under the proposed method for the current taxable year compared to actual experience for old taxable years rather than a comparison of the results under the proposed method for the current taxable year compared to actual experience for the current taxable year at the time of filing, provided the taxpayer can demonstrate that there is not a change in the type of a substantial portion of the outstanding accounts receivable such that the risk of loss is substantially decreased? What standards should apply to a taxpayer who has had a change in the type of a substantial portion of the outstanding accounts receivable? If a taxpayer's business has changed in a manner that impacts a substantial portion of its outstanding accounts receivable, the taxpayer's historical data for its receivables could lose much of their relevance in determining the taxpayer's current nonaccrual experience.

c. Safe Harbor Comparison Method

The final regulations retain a modified version of the self-test from the 2003 regulations, which required the comparison of a taxpayer's method against one of the safe harbors. The safe harbor comparison method in the final regulations is used in conjunction with the fifth safe harbor nonaccrual-experience method, which allows a taxpayer to use any nonaccrual-experience method provided the method meets the safe harbor comparison method of self-testing. The safe harbor comparison method provided in the final regulations allows a taxpayer to compare the taxpayer's method against any of the safe harbors 1 through 4 during any self-testing period, rather than requiring the safe harbor chosen for comparison to be treated as a method of accounting. Because any of the safe harbors 1 through 4 are deemed to clearly reflect experience, a taxpayer should be able to compare its method against any of the safe harbors 1 through 4 to determine whether its method clearly reflects experience. The IRS and Treasury Department anticipate that the procedures for changes in method of accounting to use the new safe harbor nonaccrual-experience method will be provided in administrative guidance, and that these changes will be made with automatic consent.

d. Methods That Do Not Clearly Reflect Experience

The 2003 regulations provide, as part of the three-year self-test requirement, that if the taxpayer's cumulative alternative nonaccrual-experience amount excluded from income during the test period exceeds the taxpayer's cumulative safe harbor nonaccrual-experience amount, the taxpayer must

recapture the excess into income in the third taxable year of the three-year self-test. The IRS and Treasury Department intended this recapture provision to allow minor variances or fluctuations produced by the taxpayer's nonaccrual-experience method without prohibiting continued use of the method. However, when the taxpayer's nonaccrual-experience method produces results that are more than minor variations or fluctuations from the three-year self-test amounts, the method does not clearly reflect the taxpayer's experience. The recapture provision addresses situations in which the taxpayer's nonaccrual-experience method generally clearly reflects experience, but the taxpayer has an anomalous taxable year in which the method does not clearly reflect experience. However, methods may consistently provide large distortions from the taxpayer's actual experience in future taxable years despite meeting the requirements of the first-year self-test. Consequently, the final regulations include a limit in the three-year self-testing provisions that, if exceeded, deems the taxpayer's nonaccrual-experience method to not clearly reflect the taxpayer's experience. Because the taxpayer must recapture the difference between the uncollectible amount under the taxpayer's nonaccrual-experience method and the taxpayer's actual experience, a change from the taxpayer's nonaccrual-experience method to a permissible method in the subsequent taxable year does not require a section 481(a) adjustment and is made on a cut-off basis.

Additionally, to provide transparency, the IRS and Treasury Department intend to provide in future guidance descriptions of methods and characteristics of methods combined with specific taxpayer circumstances that do not clearly reflect experience.

e. Other

Commentators suggested that the self-test was not administrable in the context of consolidated groups. The IRS and Treasury Department believe that the final regulations do not impose more burden than any other method of accounting in the context of a consolidated group. Generally, methods of accounting, including the nonaccrual-experience method with its self-testing requirement, are adopted and applied separately by each entity within the consolidated group (or to separate trades or businesses within an entity), not at the consolidated group level.

3. Safe Harbor Methods

The 2003 regulations have four safe harbors: Safe harbor 1 (the six-year moving average method), safe harbor 2 (the actual experience method), safe harbor 3 (the modified Black Motor method), and safe harbor 4 (the modified moving average method). Comments were received regarding safe harbors 1, 2, and 4. No comments were received regarding safe harbor 3.

a. General Issues

Commentators questioned the need to impose different time periods for different safe harbor methods. For example, in the 2003 regulations, safe harbors 1, 3 and 4 are based on a six-year period (the current taxable year and the five immediately preceding taxable years), whereas safe harbor 2 is based on a three year period (the current taxable year and the two immediately preceding taxable years). These commentators recommended that, for consistency, the safe harbor methods should permit taxpayers to compute the uncollectible amounts using a period consisting of the current taxable year and no fewer than the two immediately preceding taxable years and no more than the five immediately preceding taxable years.

Providing options among the safe harbors, including those with different time periods, is consistent with legislative intent to provide taxpayers ''with alternative computations or formulas that taxpayers may rely upon.'' Different taxpayers may choose different methods with different time periods based on their individual circumstances and experience. The final regulations allow taxpayers flexibility to choose a period of at least three taxable years, but not more than six taxable years (applicable period), for purposes of the computations in each of the safe harbors. The taxable years included in the applicable period must be the most recent (which may or may not include the current taxable year, as applicable) and must be consecutive.

Additionally, commentators stated that including the current taxable year in computations can cause difficulties when preparing computations for estimated taxes. Therefore, the final regulations allow taxpayers flexibility with regard to whether the current taxable year is included in the applicable period. The choice of which taxable years and how many are included in the applicable period is part of the taxpayer's method of accounting under a safe harbor, and can be changed only with the consent of the Commissioner. Taxpayers making such a change may not have all the historical data necessary to compute a section 481(a) adjustment. Therefore, the final regulations provide that the change is done on a cut-off basis rather than with a section 481(a) adjustment.

Finally, some commentators reiterated their earlier suggestion that the Black Motor formula should be permitted as an additional safe harbor method. The IRS and Treasury Department continue to conclude that the Black Motor formula should not be provided as an additional safe harbor method because the formula overstates the uncollectible amount in many circumstances. The final regulations add a fifth safe harbor, which, as discussed above, allows taxpayers to use any alternative nonaccrual-experience method provided the method meets the requirements of the safe harbor comparison method under the self-testing requirements. The IRS and Treasury Department may provide additional safe harbors through future published guidance. In addition, if a taxpayer does not wish to rely on one of the safe harbors, the final regulations provide that a taxpayer may use any other alternative nonaccrual-experience method provided the method clearly reflects its experience and the taxpayer requests and receives consent from the Commissioner to use such method.

Commentators requested that the regulations specifically include a statement that unintentional or immaterial variances will not cause a taxpayer to be changed to the specific charge-off method. As discussed in the preamble to the 2003 regulations, the IRS and Treasury Department do not contemplate that a taxpayer be changed to the specific charge-off method due to unintentional or immaterial variances, especially if a taxpayer is disadvantaged by the variances. Such a rule is unnecessary, particularly with the flexibility added to each of the safe harbors

b. Safe Harbor 1—Revenue-Based Moving Average Method

Safe harbor 1 in the 2003 regulations was referred to as the six-year moving average method. It is renamed the revenue-based moving average method in the final regulations to reflect the flexibility to choose between three to six taxable years for the applicable period. The final regulations provide that the revenue-based moving average percentage of safe harbor 1 (the ratio of net write-offs for the applicable period over accounts receivable earned over the same applicable period) is multiplied by a taxpayer's accounts receivable balance at the end of the taxable year to determine the taxpayer's nonaccrual-experience amount.

A commentator suggested that a safe harbor method should be added that

would modify safe harbor 1 to multiply the revenue-based moving average percentage by a taxpayer's total billings (accounts receivable earned during the taxable year in lieu of its accounts receivable balance at the end of the taxable year). The commentator suggested that this new safe harbor would provide symmetry between the denominator of the revenue-based moving average percentage and the amount against which the revenue-based moving average percentage is multiplied.

The final regulations do not adopt this recommendation. The IRS and Treasury Department previously analyzed the effects of multiplying the revenue-based moving average percentage by the total billings during the taxable year and determined that this computation overstates that portion of the taxpayer's year-end accounts receivable balance that will not be collected. The existing formula is the method provided in former § 1.448–2T(e)(2), as contained in TD 8194, 53 FR 12513 (1988). Although the denominator and multiplicand are not symmetrical, the method accurately reflects the year-end receivables that will not be collected for taxpayers with a short collection cycle.

c. Safe Harbor 2—Actual Experience Method

Under safe harbor 2 of the 2003 regulations, the taxpayer's adjusted nonaccrual-experience amount is determined by tracking 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 determination date. The determination date is the date selected by the taxpayer for the taxable year for purposes of safe harbor 2, and 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 the return for that taxable year. Under Option A of safe harbor 2, the computation is repeated for the taxpayer's accounts receivable balance at the beginning of each of the two immediately preceding taxable years. Under Option B of safe harbor 2, taxpayers that do not have the information necessary to compute a three-year moving average in the first taxable year the method is used are allowed to transition into the method year-by-year. The total of the amounts determined to be uncollectible is divided by the total beginning accounts receivable balance for those taxable years used in the computation to determine the taxpayer's three-year (Option A), or up to three-year (Option B), moving average percentage. This percentage is then multiplied by the taxpayer's current year-end accounts receivable balance to arrive at the taxpayer's actual nonaccrual-experience amount. The taxpayer's actual nonaccrual-experience amount is then multiplied by 1.05 to determine the taxpayer's adjusted nonaccrual-experience amount.

As discussed above, the final regulations allow flexibility in the applicable period used in safe harbor 2. Additionally, because the final regulations provide definitions of terms used throughout the regulations for consistency, the terms used to describe the safe harbor 2 formula were changed to conform to the definitions in the final regulations. Although the description of the method may look as though it has changed substantially, the safe harbor 2 method is not intended to operate differently than the 2003 regulations, other than the flexibility in the applicable period and, as discussed below, the flexibility in the determination dates and in tracing recoveries.

Some commentators requested clarification as to whether safe harbor 2 is based on a computation that takes into account all known information arising both before and after the determination date. The commentators suggested that the 2003 regulations may be interpreted as taking into account only all known information arising on or before determination dates for previous taxable years involved in the computation.

The computation in safe harbor 2, Option A, in the final regulations, contemplates consideration of all known information arising on or before the determination date for the current taxable year, including beginning accounts receivable balances, charge-offs and recoveries, with respect to all taxable years included in the computation. For example, if an account receivable of a calendar year taxpayer exists on January 1, 2006, and is charged off as a bad debt on December 15, 2007, the bad debt should be included in the computation in the taxable year it is charged off and every subsequent taxable year for as long as the 2006 beginning of the year accounts receivable balance is part of the computation under this method. Consequently, the final regulations clarify that all known information arising on or before the determination date for the current taxable year, with respect to the taxable years included in the computation, should be considered.

In the 2003 regulations, Option B allows a taxpayer to transition into the actual experience safe harbor method. The final regulations allow a new taxpayer with no beginning accounts receivable to transition under either Option A or Option B (*see* § 1.448–2(d)(4) of the final regulations). Option B in the final regulations differs from Option A in that it allows a taxpayer to use multiple determination dates (one for each taxable year of the applicable period) instead of one determination date. Therefore, under Option B in the final regulations, a taxpayer has a choice of the applicable period, three to six taxable years, and the taxpayer uses separate determination dates for each taxable year in the applicable period. That is, a taxpayer must use bad debts sustained by the separate determination date of each taxable year during the applicable period rather than bad debts sustained by the determination date of the current taxable year. The determination date used for each taxable year must be the determination date originally used for each taxable year at the time the uncollectible amount for that taxable year was computed. For example, if an account receivable of a calendar year taxpayer exists on January 1, 2006, and is charged off as a bad debt on December 15, 2007, and the determination date for the 2006 taxable year is September 1, 2007, the bad debt would never be included in the computation because it is charged off after the 2006 taxable year determination date. This method was requested by commentators to reduce the burden of having to update the total bad debts for a particular taxable year with every future computation that included that taxable year.

Other commentators requested clarification as to whether the determination date used in safe harbor 2 may shift from year to year. These commentators recommended that the final regulations confirm that a taxpayer may use a different determination date each taxable year, and that a change of determination date is not a change in method of accounting. Safe harbor 2 contemplates that a taxpayer may file its Federal income tax return at different times from year to year, and that the choice of a determination date used in the computation is not a method of accounting. However, once a determination date is selected and used for a particular taxable year, it may not be changed for that taxable year. Therefore, the final regulations clarify that the determination date may be different from year to year, and that a

change in the determination date is not a change in method of accounting.

Under Option B of safe harbor 2, the 2003 regulations provide that a newly formed taxpayer that chooses Option B 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 that can be tracked. Some commentators recommended that the final regulations either permit newly formed taxpayers using Option B to exclude a portion of their year-end accounts receivable balance, or in the alternative, clarify the rules for adopting this safe harbor in the taxpayer's first taxable year in order to eliminate the administrative burden of filing Form 3115, ''Application for Change in Accounting Method,'' in the succeeding taxable year. The final regulations retain this special rule in § 1.448–(d)(4) for both safe harbor 2 and safe harbor 4, because the methods require a beginning accounts receivable balance to compute the uncollectible amount. Use of another method in the first taxable year may not clearly reflect experience. The final regulations clarify that the taxpayer must begin creating its moving average in its second taxable year by tracking the accounts receivable as of the first day of its second taxable year. The use of one of the safe harbor nonaccrual-experience methods of accounting described in paragraph (f)(2), (f)(4), or (f)(5), if applicable, of the final regulations in a taxpayer's second taxable year in this situation is not a change in method of accounting. Although the taxpayer must maintain the books and records necessary to perform the computations under the adopted safe harbor nonaccrual-experience method, the taxpayer is not required to affirmatively elect the method on its Federal income tax return for its first taxable year.

Commentators requested that safe harbor 2 be modified to permit taxpayers to use any reasonable method to determine recoveries. In response to commentators' concerns about whether taxpayers could use assumptions regarding recoveries rather than specifically trace, the preamble to the 2003 regulations stated that the IRS and Treasury Department do not intend that a taxpayer be changed to the specific charge-off method due to unintentional and/or immaterial variances, especially if the taxpayer is disadvantaged by such variances. Some commentators believe that despite the preamble, the 2003 regulations may require taxpayers to specifically trace 100% of recoveries. The IRS and Treasury Department did not intend to prevent taxpayers from using a method that allocates 100% of recoveries to current taxable year bad debts. Commentators also have stated that although some recoveries may be traceable, some recoveries may not be traceable due to lump sum recoveries from third parties.

The final regulations provide that a taxpayer specifically should trace recoveries if the taxpayer is able to do so without undue burden. However, the IRS and Treasury Department believe if the taxpayer is unable specifically to trace all recoveries without undue burden, the taxpayer should be able to use any reasonable method in determining the amount of recoveries to be traced to each taxable year's bad debts. Therefore, the final regulations allow taxpayers to use a reasonable allocation method. A method will be considered reasonable if there is a cause and effect relationship between the allocation base or ratio and the recoveries. The final regulations also provide that a taxpayer may trace only recoveries that are traceable and allocate the remaining, untraceable, recoveries to charge-offs of amounts in the relevant beginning accounts receivable balances. Methods that include, for example, receivables for which the nonaccrual-experience method is not allowed to be used (*see* § 1.448–2(c)(1)(ii)) generally will not be considered reasonable.

d. Safe Harbor 3—Modified Black Motor Method

Safe harbor 3 is a variation of the formula addressed in *Black Motor Co.* v. *Commissioner*, 41 B.T.A. 300 (1940), *aff'd*, 125 F.2d 977 (6th Cir. 1942). No comments were received regarding safe harbor 3. The final regulations adopt the method in the 2003 regulations, with minor revisions made to the terms used in the formulas to conform the terms used throughout the regulations.

e. Safe Harbor 4—Modified Moving Average Method

The 2003 regulations provide that, for purposes of safe harbor 4, a taxpayer may determine the uncollectible amount by multiplying its accounts receivable balance at the end of the current taxable year by the ratio of total bad debts charged off for the current taxable year and the five preceding taxable years other than the credit charges (accounts receivable) that were charged off in the same taxable year they were generated, adjusted for recoveries of charge-offs during that period, to the sum of accounts receivable at the end of the current taxable year and the five preceding taxable years.

Some commentators argued that, by eliminating credit charges that were written off in the same taxable year they were generated, the effect of this computation for a taxpayer's first taxable year is to eliminate the intended benefit of section 448(d)(5). These commentators recommended that the final regulations permit newly formed taxpayers using safe harbor 4 to exclude a portion of their year-end accounts receivable balance, or in the alternative, clarify the rules on adopting this safe harbor method in the taxpayer's first taxable year in order to eliminate the administrative burden of filing Form 3115 in the succeeding taxable year.

This safe harbor method, like safe harbor 3, is a variation of the formula addressed in *Black Motor Co.* v. *Commissioner.* Safe harbor 4, by eliminating credit charges that were written off in the same taxable year they were generated, and thereby reducing the amount computed under the traditional Black Motor formula, remedies known shortcomings generally associated with the Black Motor formula, and as such, more accurately reflects a taxpayer's nonaccrual-experience. Therefore, the final regulations retain this rule.

Another commentator pointed out that there is a mismatching in the comparison of write-offs to accounts receivable in the formula used in safe harbor 4 because it compares the total accounts written off in a taxable year after the year of sale to the ending balances in accounts receivable for the six-year period. For example, the sum of the write-offs in each taxable year for the preceding taxable years' charges for services in year 7 is for services rendered in years 1 through 6, but the ending balances in accounts receivable are from years 2 through 7. This commentator opined that, if charges for services and accounts receivable are increasing, the ratio of write-offs from prior balances relative to current receivables would be understated and therefore the uncollectible amount would be understated. The commentator suggested that the sum of the write-offs in each taxable year for the preceding taxable years' charges for services should be divided by the sum of the beginning accounts receivable for the current and five preceding taxable years. The final regulations adopt this recommendation and, for purposes of safe harbor 4, the denominator is changed to reflect the beginning of the taxable year accounts receivable balances in lieu of accounts receivable balances at the end of the taxable year.

4. Special Rules

a. Acquisitions and Dispositions

A commentator recommended that the final regulations clarify that newly formed or acquired taxpayers in a section 351(a) or 721(a) nontaxable transaction are allowed to use predecessor data to compute their uncollectible amount under the nonaccrual-experience method. The final regulations adopt this comment and provide special rules for acquisitions and dispositions. Taxpayers that acquire a major portion of a trade or business or a unit of a trade or business (for example, a hospital) should include the data from the predecessor in the computations to avoid potentially skewing the computations for the remainder of the applicable period. Additionally, taxpayers that dispose of a major portion of a trade or business or a unit of a trade or business should not use the data related to the disposed trade or business in the computations. For purposes of the nonaccrual-experience methods of accounting, a new, qualified taxpayer that acquires property in any transaction to which section 381(a) does not apply must adopt a nonaccrual-experience method on the basis of its own experience. However, to the extent predecessor information is available, the data must be used in the newly-adopted nonaccrual-experience method.

b. Reportable Transactions

Some commentators recommended that the book-tax difference that may result from the use of the nonaccrual-experience method not be taken into account in determining whether a transaction is a reportable transaction for purposes of the disclosure rules under § 1.6011–4(b)(6). As a result of Notice 2006–6 (2006–5 I.R.B. 385), book-tax differences no longer create reportable transactions under § 1.6011–4(b)(6). Therefore, it is not necessary to adopt this recommendation.

c. Short Taxable Years

As discussed, the 2003 regulations generally provide procedures for taxpayers that have fewer than the requisite number of taxable years to adopt or change to a safe harbor nonaccrual-experience method. Some commentators requested rules on how taxpayers may compute their nonaccrual-experience amount in the case of a short taxable year. Commentators opined that for certain safe harbors, such as safe harbors 2, 3 and 4, inaccurate income exclusion can arise because a short taxable year will have a disproportionate effect on the numerator and denominator of the computations. For example, a taxpayer that has a relatively stable balance of accounts receivable but a short period, such as three months, may generate only one-fourth of the normal write-offs. These commentators recommended that the final regulations provide that, if a taxpayer experiences a short taxable year, the net write-offs for the short period should be annualized in order to prevent distortion of the safe harbor computation. Alternatively, these commentators suggested that taxpayers should be allowed to include data from the previous twelve months in the safe harbor computation. For example, for a calendar year taxpayer who experiences a short period ending March 31st, the taxpayer would use data from the twelve months prior to the period ending on March 31st to compute its nonaccrual-experience amount.

The final regulations provide that taxpayers must make appropriate adjustments for short taxable years for nonaccrual-experience methods that are based on a comparison of accounts receivable balance to total bad debts. The IRS and Treasury Department intend to issue administrative guidance on appropriate adjustments.

d. Periodic Systems

As with the 2003 regulations, the final regulations provide, in § 1.448–2(d)(2), that a taxpayer applies its nonaccrual-experience method with respect to each specific account receivable eligible for the method. The preamble to the 2003 regulations states that a taxpayer may continue to use the periodic system described in Notice 88–51 (1988–1 C.B. 535) in conjunction with any permissible nonaccrual-experience method used by the taxpayer. The use of a periodic method remains permissible under § 1.448–2(d)(2) of the final regulations.

5. Effective Date

These final regulations are applicable to taxable years ending on or after August 31, 2006. A commentator recommended that the final regulations be applied retroactively to allow taxpayers to settle any open taxable year in which the nonaccrual-experience method is an issue under consideration in examination, in Appeals, or before the U.S. Tax Court by using one of the safe harbor methods, and thus, avoid continued disagreements between the government and taxpayers. The final regulations do not adopt this recommendation. However, the Commissioner may settle an earlier taxable year on the basis of a safe harbor method that clearly reflects the taxpayer's experience.

6. Procedures for Adoption or Change in Method of Accounting

The 2003 regulations include specific rules for filing an application to change to a nonaccrual-experience method of accounting. The final regulations omit these rules, which will be provided in administrative guidance. The guidance will include automatic consent procedures for filing an application to change to one of the safe harbor nonaccrual-experience methods of accounting.

To adopt or change to a method other than one of the safe harbor nonaccrual-experience methods of accounting, a taxpayer must request advance consent under the current procedures for obtaining the consent of the Commissioner of Internal Revenue to change a method of accounting for Federal income tax purposes (*see*, for example, Rev. Proc. 97–27 (1997–1 C.B. 680) (as modified and amplified by Rev. Proc. 2002–19 (2002–1 C.B. 696), as amplified and clarified by Rev. Proc. 2002–54 (2002–2 C.B. 432)). In the interest of sound tax administration, a new taxpayer must request advance consent to adopt a method other than one of the safe harbor nonaccrual-experience methods to ensure that the method clearly reflects income and experience.

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. It also has been determined that section 553(b) and (d) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. It is hereby certified that the collection of information contained in these regulations will not have a significant regulatory impact on a substantial number of small entities. This certification is based upon the fact that the estimated burden associated with the information collection averages three hours per respondent. Moreover, for taxpayers that are eligible to use these regulations and that follow these regulations, any burden due to the collection of information in these regulations will be outweighed by the benefit received by accruing less income than would otherwise be required. Accordingly, a regulatory flexibility analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, the proposed regulations preceding these regulations were

submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

Drafting Information

The principal author of these regulations is W. Thomas McElroy, Jr. of the Office of Associate Chief Counsel (Income Tax and Accounting). However, other personnel from the IRS and Treasury Department participated in their development.

List of Subjects

26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

26 CFR Part 602

Reporting and recordkeeping requirements.

Adoption of Amendments to the Regulations

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

PART 1—INCOME TAXES

■ **Paragraph 1.** The authority citation for part 1 continues to read, in part, as follows:

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

■ **Par. 2.** Section 1.448–2 is added to read as follows:

§ 1.448–2 Nonaccrual of certain amounts by service providers.

(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. A taxpayer that 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 the taxpayer'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. 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 described in § 1.448–1T(e)(4) (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) *Application of method and treatment as method of accounting.* The rules of section 448(d)(5) and the regulations are 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 defined in section 7701(a)(14)). The nonaccrual of amounts to be received for the performance of services is a method of accounting (a nonaccrual-experience method). A change to a nonaccrual-experience method, from one nonaccrual-experience method to another nonaccrual-experience method, or to a periodic system (for example, *see* Notice 88–51 (1988–1 C.B. 535) and § 601.601(d)(2)(ii)(*b*) of this chapter), is a change in method of accounting to which the provisions of sections 446 and 481 and the regulations apply. *See* also paragraphs (c)(2)(i), (c)(5), (d)(4), and (e)(3)(i) of this section. Except as provided in other published guidance, a taxpayer who wishes to adopt or change to any nonaccrual-experience method other than one of the safe harbor methods described in paragraph (f) of this section must request and receive advance consent from the Commissioner in accordance with the applicable administrative procedures issued under § 1.446–1(e)(3)(ii) for obtaining the Commissioner's consent.

(c) *Definitions and special rules*—(1) *Accounts receivable*—(i) *In general.* Accounts receivable include only amounts that are earned by a taxpayer and otherwise recognized in income through the performance of services by the taxpayer. For purposes of determining a taxpayer's nonaccrual-experience under any method provided in this section, amounts described in paragraph (c)(1)(ii) of this section are not taken into account. Except as otherwise provided, for purposes of this section, accounts receivable do not include amounts that are not billed (such as for charitable or pro bono services) or amounts contractually not collectible (such as amounts in excess of a fee schedule agreed to by contract). *See* paragraph (g) *Examples 1* and *2* of this section for examples of this rule.

(ii) *Method not available for certain receivables*—(A) *Amounts not earned and recognized through the performance of services.* A nonaccrual-experience method of accounting may not be used with respect to amounts that are not earned by a taxpayer and otherwise recognized in income through the performance of services by the 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 the amounts through the provision of services. However, *see* paragraph (d)(3) of this section for special rules regarding acquisitions of a trade or business or a unit of a trade or business.

(B) *If interest or penalty 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, a 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 the discount. *See* paragraph (g) *Example 3* of this section for an example of this rule.

(2) *Applicable period*—(i) *In general.* The applicable period is the number of taxable years on which the taxpayer bases its nonaccrual-experience method. A change in the number of taxable years included in the applicable period is a change in method of accounting to which the procedures of section 446 apply. A change in the inclusion or exclusion of the current taxable year in the applicable period is a change in method of accounting to which the procedures of section 446 apply. A

change in the number of taxable years included in the applicable period or the inclusion or exclusion of the current taxable year in the applicable period is made on a cut-off basis.

(ii) *Applicable period for safe harbors.* For purposes of the safe harbors under paragraph (f) of this section the applicable period may consist of at least three but not more than six of the immediately preceding consecutive taxable years. Alternatively, the applicable period may consist of the current taxable year and at least two but not more than five of the immediately preceding consecutive taxable years. A period shorter than six taxable years is permissible only if the period contains the most recent preceding taxable years and all of the taxable years in the applicable period are consecutive.

(3) *Bad debts.* Bad debts are accounts receivable determined to be uncollectible and charged off.

(4) *Charge-offs.* Amounts charged off include only those amounts that would otherwise be allowable under section 166(a).

(5) *Determination date.* The determination date in safe harbor 2 provided in paragraph (f)(2) of this section is used as a cut-off date for determining all known data to be taken into account in the computation of the taxable year's uncollectible amount. 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 the return for that taxable year. The determination date may be different in each taxable year. However, once a determination date is selected and used for a particular taxable year, it may not be changed for that taxable year. The choice of a determination date is not a method of accounting.

(6) *Recoveries.* Recoveries are amounts previously excluded from income under a nonaccrual-experience method or charged off that the taxpayer recovers.

(7) *Uncollectible amount.* The uncollectible amount is the portion of any account receivable amount due that, under the taxpayer's nonaccrual-experience method, will be not collected.

(d) *Use of experience to estimate uncollectible amounts*—(1) *In general.* In determining the portion of any amount due that, on the basis of experience, will not be collected, a taxpayer may use any nonaccrual-experience method that clearly reflects the taxpayer's nonaccrual-experience. The determination of whether a nonaccrual-experience method clearly reflects the taxpayer's nonaccrual-experience is made in accordance with the rules under paragraph (e) of this section. Alternatively, the taxpayer may use any one of the five safe harbor nonaccrual-experience methods of accounting provided in paragraphs (f)(1) through (f)(5) of this section, which are presumed to clearly reflect a taxpayer's nonaccrual-experience.

(2) *Application to specific accounts receivable.* The nonaccrual-experience method is applied with respect to each account receivable of the taxpayer that is eligible for this method. With respect to a particular account receivable, the taxpayer determines, in the manner prescribed in paragraphs (d)(1) or (f)(1) through (f)(5) of this section (whichever applies), the uncollectible amount. The determination is required to be made only once with respect to each account receivable, regardless of the term of the receivable. The uncollectible amount is not recognized as gross income. Thus, the amount recognized as gross income is the amount that would otherwise be recognized as gross income with respect to the account receivable, less the uncollectible amount. 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 may not deduct in any subsequent taxable year the amount excluded from income. Thus, the taxpayer may not 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 (for example, a calendar-year taxpayer determines on November 1st that an account receivable that was originated on May 1st of the same taxable 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 determination that amounts are uncollectible and should be charged off may be considered on examination. *See* paragraph (g) *Example 12* of this section for an example of this rule.

(3) *Acquisitions and dispositions*—(i) *Acquisitions.* If a taxpayer acquires the major portion of a trade or business of another person (predecessor) or the major portion of a separate unit of a trade or business of a predecessor, then, for purposes of applying this section for any taxable year ending on or after the acquisition, the experience from preceding taxable years of the predecessor attributable to the portion of the trade or business acquired, if available, must be used in determining the taxpayer's experience.

(ii) *Dispositions.* If a taxpayer disposes of a major portion of a trade or business or the major portion of a separate unit of a trade or business, and the taxpayer furnished the acquiring person the information necessary for the computations required by this section, then, for purposes of applying this section for any taxable year ending on or after the disposition, the experience from preceding taxable years attributable to the portion of the trade or business disposed may not be used in determining the taxpayer's experience.

(iii) *Meaning of terms.* For the meaning of the terms *acquisition, separate unit,* and *major portion, see* paragraph (b) of § 1.52–2. The term *acquisition* includes an incorporation or a liquidation.

(4) *New taxpayers.* The rules of this paragraph (d)(4) apply to any newly formed taxpayer to which the rules of paragraph (d)(3)(i) of this section do not apply. Any newly formed taxpayer that wants to use a safe harbor nonaccrual-experience method of accounting described in paragraph (f)(1), (f)(2), (f)(3), (f)(4), or (f)(5) of this section applies the methods by using the experience of the actual number of taxable years available in the applicable period. A newly formed taxpayer that wants to use one of the safe harbor nonaccrual-experience methods of accounting described in paragraph (f)(2), (f)(4), or (f)(5) of this section in its first taxable year and does not have any accounts receivable upon formation may not exclude any portion of its year-end accounts receivable from income for its first taxable year. The taxpayer must begin creating its moving average in its second taxable year by tracking the accounts receivable as of the first day of its second taxable year. The use of one of the safe harbor nonaccrual-experience methods of accounting described in paragraph (f)(2), (f)(4), or (f)(5) of this section in a taxpayer's second taxable year in this situation is not a change in method of accounting. Although the taxpayer must maintain the books and records necessary to perform the computations under the adopted safe harbor nonaccrual-experience method, the taxpayer is not required to affirmatively elect the method on its Federal income tax return for its first taxable year.

(5) *Recoveries.* Regardless of the nonaccrual-experience method of accounting used by a taxpayer under this section, the taxpayer must take

recoveries into account. 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 (g) *Example 13* of this section for an example of this rule.

(6) *Request to exclude taxable years from applicable period.* A period shorter than the applicable period generally is permissible only if the 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 evidence that the accounts receivable outstanding at the close of the taxable years for the shorter period requested are more comparable in nature and risk to accounts receivable outstanding at the close of the current taxable year. 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 may not be used for any subsequent taxable year. A request for approval to exclude the experience of a prior taxable year must be made in accordance with the applicable procedures for requesting a letter ruling and must include a statement of the reasons the 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 the approval is requested.

(7) *Short taxable years.* A taxpayer with a short taxable year that uses a nonaccrual-experience method that compares accounts receivable balance to total bad debts during the taxable year should make appropriate adjustments.

(8) *Recordkeeping requirements*—(i) A taxpayer using a nonaccrual-experience method of accounting must keep sufficient books and records to establish the amount of any exclusion from gross income under section 448(d)(5) for the taxable year, including books and records demonstrating—

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

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

(C) The taxpayer's determination that amounts are uncollectible;

(D) The proper amount that is excludable under the taxpayer's nonaccrual-experience method; and

(E) The taxpayer's determination date under paragraph (c)(5) of this section (if applicable).

(ii) If a taxpayer 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, the Internal Revenue Service may change the taxpayer's method of accounting on examination. *See* § 1.6001–1 for rules regarding records.

(e) *Requirements for nonaccrual method to clearly reflect experience*—(1) *In general.* A nonaccrual-experience method clearly reflects the taxpayer's experience if the taxpayer's nonaccrual-experience method meets the self-test requirements described in this paragraph (e). If a taxpayer is using one of the safe harbor nonaccrual-experience methods described in paragraphs (f)(1) through (f)(4) of this section, its method is deemed to clearly reflect its experience and is not subject to the self-testing requirements in paragraphs (e)(2) and (e)(3) of this section.

(2) *Requirement to self-test*—(i) *In general.* A taxpayer using, or desiring to use, a nonaccrual-experience method must self-test its nonaccrual-experience method for its first taxable year for which the taxpayer uses, or desires to use, that nonaccrual-experience method (first-year self-test) and every three taxable years thereafter (three-year self-test). Each self-test must be performed by comparing the uncollectible amount (under the taxpayer's nonaccrual-experience method) with the taxpayer's actual experience. A taxpayer using the safe harbor under paragraph (f)(5) of this section must self-test using the safe harbor comparison method in paragraph (e)(3) of this section.

(ii) *First-year self-test.* The first-year self-test must be performed by comparing the uncollectible amount with the taxpayer's actual experience for its first taxable year for which the taxpayer uses, or desires to use, that nonaccrual-experience method. If the uncollectible amount for the first-year self-test is less than or equal to the taxpayer's actual experience for its first taxable year for which the taxpayer uses, or desires to use, that nonaccrual-experience method, the taxpayer's nonaccrual-experience method is treated as clearly reflecting its experience for the first taxable year. If, as a result of the first-year self-test, the uncollectible amount for the test period is greater than the taxpayer's actual experience, then—

(A) The taxpayer's nonaccrual-experience method is treated as not clearly reflecting its experience;

(B) The taxpayer is not permitted to use that nonaccrual-experience method in that taxable year; and

(C) The taxpayer must change to (or adopt) for that taxable year either—

(*1*) Another nonaccrual-experience method that clearly reflects experience, that is, a nonaccrual-experience method that meets the first-year self-test requirement; or

(*2*) A safe harbor nonaccrual-experience method described in paragraphs (f)(1) through (f)(5) of this section.

(iii) *Three-year self-test*—(A) *In general.* The three-year self-test must be performed by comparing the sum of the uncollectible amounts for the current taxable year and prior two taxable years (cumulative uncollectible amount) with the sum of the taxpayer's actual experience for the current taxable year and prior two taxable years (cumulative actual experience amount).

(B) *Recapture.* If the cumulative uncollectible amount for the test period is greater than the cumulative actual experience amount for the test period, the taxpayer's uncollectible amount is limited to the cumulative actual experience amount for the test period. Any excess of the taxpayer's cumulative uncollectible amount over the taxpayer's cumulative actual nonaccrual-experience amount excluded from income during the test period must be recaptured into income in the third taxable year of the three-year self-test period.

(C) *Determination of whether method is permissible or impermissible.* If the cumulative uncollectible amount is less than 110 percent of the cumulative actual experience amount, the taxpayer's nonaccrual-experience method is treated as a permissible method and the taxpayer may continue to use its alternative nonaccrual-experience method, subject to the three-year self-test requirement of this paragraph (e)(2)(iii). If the cumulative uncollectible amount is greater than or equal to 110 percent of the cumulative actual experience amount, the taxpayer's nonaccrual-experience method is treated as impermissible in the taxable year subsequent to the three-year self-test year and does not clearly reflect its experience. The taxpayer must change to another nonaccrual-experience method that clearly reflects experience, including, for example, one of the safe harbor nonaccrual-experience

methods described in paragraphs (f)(1) through (f)(5) of this section, for the subsequent taxable year. A change in method of accounting from an impermissible method under this paragraph (e)(2)(iii)(C) to a permissible method in the taxable year subsequent to the three-year self-test year is made on a cut-off basis.

(iv) *Determination of taxpayer's actual experience.* [Reserved.]

(3) *Safe harbor comparison method*—(i) *In general.* A taxpayer using, or desiring to use, a nonaccrual-experience method under the safe harbor in paragraph (f)(5) of this section must self-test its nonaccrual-experience method for its first taxable year for which the taxpayer uses, or desires to use, that nonaccrual-experience method (first-year self-test) and every three taxable years thereafter (three-year self-test). A nonaccrual-experience method under the safe harbor in paragraph (f)(5) of this section is deemed to clearly reflect experience provided all the requirements of the safe harbor comparison method of this paragraph (e)(3) are met. Each self-test must be performed by comparing the uncollectible amount (under the taxpayer's nonaccrual-experience method) with the uncollectible amount that would have resulted from use of one of the safe harbor methods described in paragraph (f)(1), (f)(2), (f)(3), or (f)(4) of this section. A change from a nonaccrual-experience method that uses the safe harbor comparison method for self-testing to a nonaccrual-experience method that does not use the safe harbor comparison method for self-testing, and vice versa, is a change in method of accounting to which the provisions of sections 446 and 481 and the regulations apply. A change solely to use or discontinue use of the safe harbor comparison method for purposes of determining whether the nonaccrual-experience method clearly reflects experience must be made on a cut-off basis and without audit protection.

(ii) *Requirements to use safe harbor comparison method*—(A) *First-year self-test.* The first-year self-test must be performed by comparing the uncollectible amount with the uncollectible amount determined under any of the safe harbor methods described in paragraph (f)(1), (f)(2), (f)(3), or (f)(4) of this section (safe harbor uncollectible amount) for its first taxable year for which the taxpayer uses, or desires to use, that nonaccrual-experience method. If the uncollectible amount for the first-year self-test is less than or equal to the safe harbor uncollectible amount, then the taxpayer's nonaccrual-experience method is treated as clearly reflecting its experience for the first taxable year. If, as a result of the first-year self-test, the uncollectible amount for the test period is greater than the safe harbor uncollectible amount, then—

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

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

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

(*i*) Another nonaccrual-experience method that clearly reflects experience, that is, a nonaccrual-experience method that meets the first-year self-test requirement; or

(*ii*) A safe harbor nonaccrual-experience method described in paragraphs (f)(1) through (f)(5) of this section.

(B) *Three-year self-test.* The three-year self-test must be performed by comparing the sum of the uncollectible amounts for the current taxable year and prior two taxable years (cumulative uncollectible amount) with the sum of the uncollectible amount determined under any of the safe harbor methods described in paragraph (f)(1), (f)(2), (f)(3), or (f)(4) of this section for the current taxable year and prior two taxable years (cumulative safe harbor uncollectible amounts). If the cumulative uncollectible amount for the three-year self-test is less than or equal to the cumulative safe harbor uncollectible amount for the test period, then the taxpayer's nonaccrual-experience method is treated as clearly reflecting its experience for the test period and the taxpayer may continue to use that nonaccrual-experience method, subject to a requirement to self-test again after three taxable years. If the cumulative uncollectible amount for the test period is greater than the cumulative safe harbor uncollectible amount for the test period, the taxpayer's uncollectible amount is limited to the cumulative safe harbor uncollectible amount for the test period. Any excess of the taxpayer's cumulative uncollectible amount over the taxpayer's cumulative safe harbor uncollectible amount excluded from income during the test period must be recaptured into income in the third taxable year of the three-year self-test period. If the cumulative uncollectible amount is less than 110 percent of the cumulative safe harbor uncollectible amount, the taxpayer's nonaccrual-experience method is treated as a permissible method and the taxpayer may continue to use its alternative nonaccrual-experience method, subject to the three-year self-test requirement of this paragraph (e)(3)(ii)(B). If the cumulative uncollectible amount is greater than or equal to 110 percent of the cumulative safe harbor uncollectible amount, the taxpayer's nonaccrual-experience method is treated as impermissible in the taxable year subsequent to the three-year self-test year and does not clearly reflect its experience. The taxpayer must change to another nonaccrual-experience method that clearly reflects experience, including, for example, one of the safe harbor nonaccrual-experience methods described in paragraphs (f)(1) through (f)(5) of this section, for the subsequent taxable year. A change in method of accounting from an impermissible method under this paragraph (e)(3)(ii)(B) to a permissible method in the taxable year subsequent to the three-year self-test year is made on a cut-off basis.

(4) *Methods that do not clearly reflect experience.* [Reserved.]

(5) *Contemporaneous documentation.* For purposes of this paragraph (e), including the safe harbor comparison method of paragraph (e)(3) 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 method used to conduct the self-test, including appropriate documentation and computations that resulted in the determination that the taxpayer's nonaccrual-experience method clearly reflected the taxpayer's nonaccrual-experience for the applicable test period.

(f) *Safe harbors*—(1) *Safe harbor 1: revenue-based moving average method.* A taxpayer may use a nonaccrual-experience method under which the taxpayer determines the uncollectible amount by multiplying its accounts receivable balance at the end of the current taxable year by a percentage (revenue-based moving average percentage). The revenue-based moving average percentage is computed by dividing the total bad debts sustained, adjusted by recoveries received, throughout the applicable period by the total revenue resulting in accounts receivable earned throughout the applicable period. *See* paragraph (g) *Example 4* of this section for an example of this method. Thus, the uncollectible amount under the revenue-based moving average method is computed:

$$\frac{\text{Bad debts sustained, adjusted by recoveries received, during the applicable period}}{\text{Total revenue resulting in accounts receivable during the applicable period}} \times \text{Accounts receivable at end of current taxable year}$$

(2) *Safe harbor 2: actual experience method—(i) Option A: single determination date.* A taxpayer may use a nonaccrual-experience method under which the taxpayer determines the uncollectible amount by multiplying its accounts receivable balance at the end of the current taxable year by a percentage (moving average nonaccrual-experience percentage) and then increasing the resulting amount by 5 percent. *See* paragraph (g) *Example 5* of this section for an example of safe harbor 2 in general, and paragraph (g) *Example 6* of this section for an example of the single determination date option of safe harbor 2. The taxpayer's moving average nonaccrual-experience percentage is computed by dividing the total bad debts sustained, adjusted by recoveries that are allocable to the bad debts, by the determination date of the current taxable year related to the taxpayer's accounts receivable balance at the beginning of each taxable year during the applicable period by the sum of the accounts receivable at the beginning of each taxable year during the applicable period. Thus, the uncollectible amount under Option A of the actual experience method is computed:

$$\frac{\text{Bad debts sustained, adjusted by recoveries received that are allocable to the bad debts, by the determination date of the current taxable year related to the taxpayer's accounts receivable balance at the beginning of each taxable year during the applicable period}}{\text{Sum of accounts receivable at the beginning of each taxable year during the applicable period}} \times \text{Accounts receivable at end of current taxable year} \times 1.05$$

(ii) *Option B: multiple determination dates.* Alternatively, in computing its bad debts related to the taxpayer's accounts receivable balance at the beginning of each taxable year during the applicable period, a taxpayer may use the original determination date for each taxable year during the applicable period. That is, the taxpayer may use bad debts sustained, adjusted by recoveries received that are allocable to the bad debts, by the determination date of each taxable year during the applicable period rather than the determination date of the current taxable year. *See* paragraph (g) *Example 7* of this section for an example of the multiple determination date option of safe harbor 2. Thus, the uncollectible amount under Option B of the actual experience method is computed:

$$\frac{\text{Sum of, for each taxable year during the applicable period, bad debts sustained, adjusted by recoveries received that are allocable to the bad debts, by that taxable year's determination date and related to the taxpayer's accounts receivable balance at the beginning of the taxable year}}{\text{Sum of accounts receivable at the beginning of each taxable year during the applicable period}} \times \text{Accounts receivable at end of current taxable year} \times 1.05$$

(iii) *Tracing of recoveries*—(A) *In general.* Bad debts related to the taxpayer's accounts receivable balance at the beginning of each taxable year during the applicable period must be adjusted by the portion, if any, of recoveries received that are properly allocable to the bad debts.

(B) *Specific tracing.* If a taxpayer, without undue burden, can trace all recoveries to their corresponding charge-offs, the taxpayer must specifically trace all recoveries.

(C) *Recoveries cannot be traced without undue burden.* If a taxpayer has any recoveries that cannot, without undue burden, be traced to corresponding charge-offs, the taxpayer may allocate those or all recoveries between charge-offs of amounts in the relevant beginning accounts receivable balances and other charge-offs using an allocation method that is reasonable under all of the facts and circumstances.

(*1*) *Reasonable allocations.* An allocation method is reasonable if there is a cause and effect relationship between the allocation base or ratio and the recoveries. A taxpayer may elect to trace recoveries that are traceable and allocate all untraceable recoveries to charge-offs of amounts in the relevant beginning accounts receivable balances. Such an allocation method will be deemed to be reasonable under all the facts and circumstances.

(*2*) *Allocations that are not reasonable.* Allocation methods that generally will not be considered reasonable include, for example, methods in which there is not a cause and effect relationship between the allocation base or ratio and methods in which receivables for which the nonaccrual-experience method is not allowed to be used are included in the allocation. *See* paragraph (c)(1)(ii) of this section for examples of receivables for which the nonaccrual-experience method is not allowed.

(3) *Safe harbor 3: modified Black Motor method.* A taxpayer may use a nonaccrual-experience method under which the taxpayer determines the uncollectible amount by multiplying its accounts receivable balance at the end of the current taxable year by a percentage (modified Black Motor moving average percentage) and then reducing the resulting amount by the bad debts written off during the current taxable year relating to accounts receivable generated during the current taxable year. The modified Black Motor moving average percentage is computed by dividing the total bad debts sustained, adjusted by recoveries received, during the applicable period

by the sum of accounts receivable at the end of each taxable year during the applicable period. *See* paragraph (g) *Example 8* of this section for an example of this method. Thus, the uncollectible amount under the modified Black Motor method is computed:

$$\frac{\text{Bad debts sustained, adjusted by recoveries received, during the applicable period}}{\text{Sum of accounts receivable at the end of each taxable year during the applicable period}} \times \text{Accounts receivable at end of current taxable year} - \text{Bad debts written off during the current taxable year relating to accounts receivable generated during the current taxable year}$$

(4) *Safe harbor 4: modified moving average method.* A taxpayer may use a nonaccrual-experience method under which the taxpayer determines the uncollectible amount by multiplying its accounts receivable balance at the end of the current taxable year by a percentage (modified moving average percentage). The modified moving average percentage is computed by dividing the total bad debts sustained, adjusted by recoveries received, during the applicable period other than bad debts that were written off in the same taxable year the related accounts receivable were generated by the sum of accounts receivable at the beginning of each taxable year during the applicable period. *See* paragraph (g) *Example 9* of this section for an example of this method. Thus, the uncollectible amount under the modified moving average method is computed:

$$\frac{\text{(Bad debts sustained, adjusted by recoveries received, during the applicable period} - \text{Bad debts written off in same taxable year accounts receivable generated)}}{\text{Sum of accounts receivable at the beginning of each taxable year during the applicable period}} \times \text{Accounts receivable at end of current taxable year}$$

(5) *Safe harbor 5: alternative nonaccrual-experience method.* A taxpayer may use an 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 paragraph (e)(3) of this section.

(g) *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 (except in the case of *Example 3*) and, in the case of *Examples 5* through *7*, selects an appropriate determination date for each taxable year. The examples are as follows:

Example 1 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. Under paragraph (c)(1)(i) 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 receivable.

Example 2. 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 provides its services to E pro bono, D's services are never billed or intended to result in revenue. Thus, under paragraph (c)(1)(i) of this section, the $500 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 receivable.

Example 3. Charging interest and/or penalties. Z has two billing methods for the amounts to be received from Z'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, Z charges interest at a market rate until the amounts (together with interest) are paid. Under the other billing method, Z charges no interest for amounts past due. Under paragraph (c)(1)(ii) 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. Z 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 4. Safe harbor 1: Revenue-based moving average method. (i) F uses the revenue-based moving average method described in paragraph (f)(1) of this section with an applicable period of six taxable years. F's total accounts receivable and bad debt experience for the 2006 taxable year and the five immediately preceding consecutive taxable years are as follows:

Taxable year	Total accounts receivable earned during the taxable year	Bad debts adjusted for recoveries
2001	$40,000	$5,700
2002	40,000	7,200
2003	40,000	11,000
2004	60,000	10,200
2005	70,000	14,000
2006	80,000	16,800
Total	330,000	64,900

(ii) F's revenue-based moving average percentage is 19.67% ($64,900/$330,000). If $49,300 of accounts receivable remains outstanding as of the close of that taxable year (2006), F's uncollectible amount using the revenue-based moving average safe harbor method is computed by multiplying $49,300 by the revenue-based moving average percentage of 19.67%, or $9,697. Thus, F may exclude $9,697 from gross income for 2006.

Example 5. Safe harbor 2: Actual experience method. (i) G is eligible to use a nonaccrual-experience method and wishes to adopt the actual experience method of paragraph (f)(2) of this section. G elects to use a three-year applicable period consisting of the current and two immediately preceding consecutive taxable years. G determines that

its actual accounts receivable collection experience is as follows:

Taxable year	Total A/R balance at beginning of taxable year	Bad debts, adjusted for recoveries, related to A/R balance at beginning of taxable year
2006	$1,000,000	$35,000
2007	760,000	75,000
2008	1,975,000	65,000
Total	3,735,000	175,000

(ii) G's ending A/R Balance on December 31, 2008, is $880,000. In 2008, G computes its uncollectible amount by using a three-year moving average under paragraph (f)(2) of this section. G's moving average nonaccrual-experience percentage is 4.7%, determined by dividing the sum of the amount of G's accounts receivable outstanding on January 1 of 2006, 2007, and 2008, that were determined to be bad debts (adjusted for recoveries allocable to the bad debts) on or before the corresponding determination date(s), by the sum of the amount of G's accounts receivable outstanding on January 1 of 2006, 2007, and 2008 ($175,000/$3,735,000 or 4.7%). G's uncollectible amount for 2008 is determined by multiplying this percentage by the balance of G's accounts receivable on December 31, 2008 ($880,000 x 4.7% = $41,360), and increasing this amount by 105% ($41,360 × 105% = $43,428). G may exclude $43,428 from gross income for 2008.

Example 6. Safe harbor 2: Single determination date (Option A). H is eligible to use a nonaccrual-experience method and wishes to adopt the actual experience method of paragraph (f)(2) of this section. H elects to use a six-year applicable period consisting of the current and five immediately preceding taxable years. H also elects to use a single determination date in accordance with paragraph (f)(2)(i) of this section. H selects December 31, its taxable year-end, as its determination date. Since H is using a single determination date from the current taxable year, its determination date for the 2001–2006 applicable period is December 31, 2006. H has a $800 charge-off in 2003 of an account receivable in the 2003 beginning accounts receivable balance. In 2005, H has a recovery of $100 which is traceable, without undue burden, to the $800 charge-off in 2003. Since the $100 recovery occurred prior to H's December 31, 2006, determination date, it reduces the amount of H's bad debts in the numerator of the formula for purposes of determining H's moving average nonaccrual-experience percentage. In addition, H must include the $100 recovery in income in 2005 (*see* paragraph (d)(5) of this section regarding recoveries).

Example 7. Safe harbor 2: Multiple determination dates (Option B). The facts are the same as in *Example 6,* except H elects to use multiple determination dates in accordance with paragraph (f)(2)(ii) of this section. Consequently, H's determination date is December 31, 2001, for its calculations of the portion of the numerator relating to the 2001 taxable year, December 31, 2002, for its calculations of the portion of the numerator relating to the 2002 taxable year, and so on through the final taxable year (2006), which has a determination date of December 31, 2006. Since the $100 recovery did not occur until after December 31, 2003 (the determination date for the 2003 taxable year), it does not reduce the amount of H's bad debts in the numerator of the formula for purposes of determining H's moving average nonaccrual-experience percentage. However, H still must include the $100 recovery in income in 2005 (*see* paragraph (d)(5) of this section regarding recoveries).

Example 8. Safe harbor 3: Modified Black Motor method. (i) J uses the modified Black Motor method described in paragraph (f)(3) of this section and a six-year applicable period. J's total accounts receivable and bad debt experience for the 2006 taxable year and the five immediately preceding consecutive taxable years are as follows:

Taxable year	Accounts receivable at end of taxable year	Bad debts (adjusted for recoveries)
2001	$130,000	$9,100
2002	140,000	7,000
2003	140,000	14,000
2004	160,000	14,400
2005	170,000	20,400
2006	180,000	10,800
Total	920,000	75,700

(ii) J's modified Black Motor moving average percentage is 8.228% ($75,700/$920,000). If the accounts receivable generated and written off during the current taxable year are $3,600, J's uncollectible amount is $11,210, computed by multiplying J's accounts receivable on December 31, 2006 ($180,000) by the modified Black Motor moving average percentage of 8.228% and reducing the resulting amount by $3,600 (J's accounts receivable generated and written off during the 2006 taxable year). J may exclude $11,210 from gross income for 2006.

Example 9. Safe harbor 4: Modified moving average method. (i) The facts are the same as in *Example 8,* except that the balances represent accounts receivable at the beginning of the taxable year, and J uses the modified moving average method described in paragraph (f)(4) of this section and a six-year applicable period. Furthermore, the accounts receivable that were written off in the same taxable year they were generated, adjusted for recoveries of bad debts during the period are as follows:

Taxable year	Accounts receivable written off in same taxable year as generated (adjusted for recoveries)
2001	$3,033
2002	2,333
2003	4,667
2004	4,800
2005	6,800
2006	3,600
Total	25,233

(ii) J's modified moving average percentage is 5.486% (($75,700 − $25,233)/$920,000). J's uncollectible amount is $9,875, computed by multiplying J's accounts receivable on December 31, 2006 ($180,000) by the modified moving average percentage of 5.486%. J may exclude $9,875 from gross income for 2006.

Example 10. First-year self-test. Beginning in 2006, K is eligible to use a nonaccrual-experience method and wants to adopt an alternative nonaccrual-experience method under paragraph (f)(5) of this section, and consequently is subject to the safe harbor comparison method of self-testing under paragraph (e)(3) of this section. K elects to self-test against safe harbor 1 for purposes of conducting its first-year self-test. K's uncollectible amount for 2006 is $22,000. K's safe harbor uncollectible amount under safe harbor 1 is $21,000. Because K's uncollectible amount for 2006 ($22,000) is greater than the safe harbor uncollectible amount ($21,000), K's alternative nonaccrual-experience method is treated as not clearly reflecting its nonaccrual experience for 2006. Accordingly, K must adopt either another nonaccrual-experience method that clearly reflects experience (subject to the self-testing requirements of paragraph (e)(2)(ii) of this section, or a safe harbor nonaccrual-experience method described in paragraph (f)(1) (revenue-based moving average), (f)(2) (actual experience method), (f)(3) (modified Black Motor method), (f)(4) (modified moving average method) of this section, or another alternative nonaccrual-experience method under paragraph (f)(5) of this section that meets the self-testing requirements of paragraph (e)(3) of this section.

Example 11. Three-year self-test. The facts are the same as in Example 10, except that K's safe harbor uncollectible amount under safe harbor 1 for 2006 is also $22,000. Consequently, K meets the first-year self-test requirement and may use its alternative nonaccrual-experience method. Subsequently, K's cumulative uncollectible amount for 2007 through 2009 is $300,000. K's safe harbor uncollectible amount for 2007 through 2009 under its chosen safe harbor method for self-testing (safe harbor 1) is $295,000. Because K's cumulative uncollectible amount for the three-year test period (taxable years 2007 through 2009) is greater than its safe harbor uncollectible amount for the three-year test period ($295,000), under paragraph (e)(3)(ii)(B) of this section, the $5,000 excess of K's cumulative uncollectible amount over K's safe harbor uncollectible amount for the three-year test period must be recaptured into income in 2009 in accordance with

paragraph (e)(3)(ii)(B) of this section. Since K's cumulative uncollectible amount for the three-year test period ($300,000) is less than 110% of its safe harbor uncollectible amount ($295,000 × 110% = $324,500), under paragraph (e)(3)(ii)(B) of this section, K may continue to use its alternative nonaccrual-experience method, subject to the three-year self-test requirement.

Example 12. Subsequent worthlessness of year-end receivable. The facts are the same as in *Example 4,* except that one of the accounts receivable outstanding at the end of 2002 was for $8,000, and in 2003, under section 166, the entire amount of this receivable becomes wholly worthless. Because F does not accrue as income $1,573 of this account receivable ($8,000 × .1967) under the nonaccrual-experience method in 2002, under paragraph (d)(2) 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 13. Subsequent collection of year-end receivable. The facts are the same as in *Example 4.* In 2007, F collects in full an account receivable of $1,700 that was outstanding at the end of 2006. Under paragraph (d)(5) of this section, F must recognize additional gross income in 2007 equal to the portion of this receivable that F excluded from gross income in the prior taxable year ($1,700 × .1967 = $334). That amount ($334) is a recovery under paragraph (d)(5) of this section.

(h) *Effective date.* This section is applicable for taxable years ending on or after August 31, 2006.

§ 1.448–2T [Removed]

■ **Par. 3.** Section 1.448–2T is removed.

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

■ **Par. 4.** The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

■ **Par. 5.** In § 602.101, paragraph (b) is amended by adding an entry in numerical order to the table to read as follows:

§ 602.101 OMB Control numbers.

* * * * *

(b) * * *

CFR part or section where identified and described	Current OMB control No.
* * * * *	
1.448–2	1545–1855
* * * * *	

Steven T. Miller,

Acting Deputy Commissioner for Services and Enforcement.

Approved: August 30, 2006.

Eric Solomon,

Acting Deputy Assistant Secretary of the Treasury (Tax Policy).

[FR Doc. 06–7446 Filed 8–31–06; 1:53 pm]

BILLING CODE 4830–01–P

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 301

[TD 9284]

RIN 1545–BC72

Collection After Assessment

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to the collection of tax liabilities after assessment. The regulations reflect changes to the law made by the Internal Revenue Service Restructuring and Reform Act of 1998. These regulations affect persons determining how long the Internal Revenue Service has to collect taxes that have been properly assessed.

DATES: *Effective Date:* These regulations are September 6, 2006.

FOR FURTHER INFORMATION CONTACT: Debra A. Kohn, (202) 622–7985 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

This document contains amendments to the Procedure and Administration Regulations (26 CFR part 301) under section 6502 of the Internal Revenue Code (Code). The regulations reflect the amendment of the Code by section 3461 of the Internal Revenue Service Restructuring and Reform Act of 1998 (RRA 1998), Public Law 105–206 (112 Stat. 685, 764).

On March 4, 2005, a notice of proposed rulemaking (REG–148701–03) relating to collection after assessment was published in the **Federal Register** (70 FR 10572). No public hearing was requested or held. Written and electronic comments responding to the notice of proposed rulemaking were received. After consideration of all the comments, the proposed regulations are adopted as amended by this Treasury decision. The revisions are discussed in this preamble.

Collection of Tax Liabilities After Assessment Under Section 6502

Pursuant to section 6502 of the Code, the IRS generally has 10 years from the date of assessment to collect a timely assessed tax liability. Prior to January 1, 2000, the effective date of section 3461 of RRA 1998, section 6502 permitted the IRS to enter into agreements with the taxpayer to extend the period of limitations on collection at any time prior to the expiration of the period provided in section 6502. Prior to the enactment of RRA 1998, the IRS used these collection extension agreements, or waivers, in various circumstances to protect its ability to collect a tax liability beyond the original 10-year period of limitations on collection. For example, the IRS historically conditioned consideration of an offer in compromise upon the execution of a collection extension agreement or waiver.

In addition, the Code contains several provisions that operate to toll the period of limitations on collection upon the occurrence of certain events. For example, section 6331(k) operates in part to suspend the period of limitations on collection for the period of time during which an offer in compromise is pending, for 30 days after rejection, and while a timely filed appeal is pending. Similarly, section 6503(h) operates to suspend the period of limitations on collection for the period of time during which the IRS is prohibited from collecting a tax due to a bankruptcy proceeding, and for 6 months thereafter. These statutory suspension provisions toll the period of limitations on collection even if the period of limitations on collection previously has been extended pursuant to an executed collection extension agreement. See *Klingshirn* v. *United States (In re Klingshirn*), 147 F.3d 526 (6th Cir. 1998).

Section 3461 of RRA 1998 amended section 6502 of the Code to limit the ability of the IRS to enter into agreements extending the period of limitations on collection. Section 3461 of RRA 1998 also included an off-Code provision governing the continued effect of collection extension agreements executed on or before December 31, 1999.

Summary of Comments and Explanation of Provisions

The final regulations incorporate the amendments made by section 3461 of RRA 1998. The regulations provide that the IRS may enter into an agreement to extend the period of limitations on collection if an extension agreement is executed: (1) At the time an installment