

owns no other deferral entity, and G is 100 percent owned by calendar year individuals. Furthermore, G's interest in G1 does not meet the de minimis rule provided in paragraph (c)(3) of this section. Thus, in order to avoid being a tiered structure, G sells its interest in G1 to an unrelated third party prior to the date G timely makes its section 444 election for its taxable year beginning November 1, 1987. Although the sale of G1 allows G to qualify to make a section 444 election, and therefore to obtain a significant tax benefit, such benefit is not unintended. Thus, paragraph (b)(3) of this section does not apply, and G may make a section 444 election for its taxable year beginning November 1, 1987.

(g) *Effective date.* This section is effective for taxable years beginning after December 31, 1986.

[T.D. 8205, 53 FR 19698, May 27, 1988]

§ 1.444-3T Manner and time of making section 444 election (temporary).

(a) *In general.* A section 444 election shall be made in the manner and at the time provided in this section.

(b) *Manner and time of making election—(1) General rule.* A section 444 election shall be made by filing a properly prepared Form 8716, "Election to Have a Tax Year Other Than a Required Tax Year," with the Service Center indicated by the instructions to Form 8716. Except as provided in paragraphs (b) (2) and (4) of this section, Form 8716 must be filed by the earlier of—

(i) The 15th day of the fifth month following the month that includes the first day of the taxable year for which the election will first be effective, or

(ii) The due date (without regard to extensions) of the income tax return resulting from the section 444 election. In addition, a copy of Form 8716 must be attached to Form 1065 or Form 1120 series form, whichever is applicable, for the first taxable year for which the section 444 election is made. Form 8716 shall be signed by any person who is authorized to sign Form 1065 or Form 1120 series form, whichever is applicable. (See sections 6062 and 6063, relating to the signing of returns.) The provisions of this paragraph (b)(1) may be illustrated by the following examples.

Example (1). A, a partnership that began operations on September 10, 1988, is qualified to make a section 444 election to use a Sep-

tember 30 taxable year for its taxable year beginning September 10, 1988. Pursuant to paragraph (b)(1) of this section, A must file Form 8716 by the earlier of the 15th day of the fifth month following the month that includes the first day of the taxable year for which the election will first be effective (*i.e.*, February 15, 1989) or the due date (without regard to extensions) of the partnership's tax return for the period September 10, 1988 to September 30, 1988 (*i.e.*, January 15, 1989). Thus, A must file Form 8716 by January 15, 1989.

Example (2). The facts are the same as in example (1), except that A began operations on October 20, 1988. Based upon these facts, A must file Form 8716 by March 15, 1989, the 15th day of the fifth month following the month that includes the first day of the taxable year for which the election will first be effective.

Example (3). B is a corporation that first becomes a personal service corporation for its taxable year beginning September 1, 1988. B qualifies to make a section 444 election to use a September 30 taxable year for its taxable year beginning September 1, 1988. Pursuant to this paragraph (b)(1), B must file Form 8716 by December 15, 1988, the due date of the income tax return for the short period September 1 to September 30, 1988.

(2) *Special extension of time for making an election.* If, pursuant to paragraph (b)(1) of this section, the due date for filing Form 8716 is prior to July 26, 1988, such date is extended to July 26, 1988. The provisions of this paragraph (b)(2) may be illustrated by the following examples.

Example (1). B, a partnership that historically used a June 30 taxable year, is qualified to make a section 444 election to retain a June 30 taxable year for its taxable year beginning July 1, 1987. Absent paragraph (b)(2) of this section, B would be required to file Form 8716 by December 15, 1987. However, pursuant to paragraph (b)(2) of this section, B's due date for filing Form 8716 is extended to July 26, 1988.

Example (2). C, a partnership that began operations on January 20, 1988, is qualified to make a section 444 election to use a year ending September 30 for its taxable year beginning January 20, 1988. Absent paragraph (b)(2) of this section, C is required to file Form 8716 by June 15, 1988 (the 15th day of the fifth month following the month that includes the first day of the taxable year for which the election will first be effective). However, pursuant to paragraph (b)(2) of this section, the due date for filing Form 8716 is July 26, 1988.

(3) *Corporation electing to be an S corporation—(i) In general.* A corporation

electing to be an S corporation is subject to the same time and manner rules for filing Form 8716 as any other taxpayer making a section 444 election. Thus, a corporation electing to be an S corporation that desires to make a section 444 election is not required to file Form 8716 with its Form 2553, "Election by a Small Business Corporation." However, a corporation electing to be an S corporation after September 26, 1988, is required to state on Form 2553 its intention to—

(A) Make a section 444 election, if qualified, or

(B) Make a "back-up section 444 election" as described in paragraph (b)(4) of this section.

If a corporation electing to be an S corporation fails to state either of the above intentions, the District Director may, at his discretion, disregard any section 444 election for such taxpayer.

(i) *Examples.* The provisions of this paragraph (b)(3) may be illustrated by the following examples.

Example (1). D is a corporation that commences operations on October 1, 1988, and elects to be an S corporation for its taxable year beginning October 1, 1988. All of D's shareholders use the calendar year as their taxable year. D desires to adopt a September 30 taxable year. D does not believe it has a business purpose for a September 30 taxable year and thus it must make a section 444 election to use such year. Based on these facts, D must, pursuant to the instructions to Form 2553, state on Form 2553 that, if qualified, it will make a section 444 election to adopt a year ending September 30 for its taxable year beginning October 1, 1988. If D is qualified (*i.e.*, D is not a member of a tiered structure on December 31, 1988) to make a section 444 election for its taxable year beginning October 1, 1988, D must file Form 8716 by March 15, 1989. If D ultimately is not qualified to make a section 444 election for its taxable year beginning October 1, 1988, D's election to be an S corporation will not be effective unless, pursuant to the instructions to Form 2553, D made a back-up calendar year election (*i.e.*, an election to adopt the calendar year in the event D ultimately is not qualified to make a section 444 election for such year).

Example (2). The facts are the same as in example (1), except that D believes it can establish, to the satisfaction of the Commissioner, a business purpose for adopting a September 30 taxable year. However, D desires to make a "back-up section 444 election" (see paragraph (b)(4) of this section) in

the event that the Commissioner does not grant permission to adopt a September 30 taxable year based upon business purpose. Based on these facts, D must, pursuant to the instructions to Form 2553, state on Form 2553 its intention, if qualified, to make a back-up section 444 election to adopt a September 30 taxable year. If, by March 15, 1989, D has not received permission to adopt a September 30 taxable year and D is qualified to make a section 444 election, D must make a back-up election in accordance with paragraph (b)(4) of this section.

(4) *Back-up section 444 election—(i) General rule.* A taxpayer that has requested (or is planning to request) permission to use a particular taxable year based upon business purpose, may, if otherwise qualified, file a section 444 election (referred to as a "back-up section 444 election"). If the Commissioner subsequently denies the business purpose request, the taxpayer will, if otherwise qualified, be required to activate the back-up section 444 election. See examples (1) and (2) in paragraph (b)(4)(iv) of this section.

(ii) *Procedures for making a back-up section 444 election.* In addition to following the general rules provided in this section, a taxpayer making a back-up section 444 election should, in order to allow the Service to process the affected returns in an efficient manner, type or legibly print the words "BACK-UP ELECTION" at the top of Form 8716, "Election to Have a Tax Year Other Than a Required Tax Year." However, if such Form 8716 is filed on or after the date a Form 1128, Application for Change in Accounting Period, is filed with respect to a period that begins on the same date, the words "FORM 1128 BACK-UP ELECTION" should be typed or legibly printed at the top of Form 8716.

(iii) *Procedures for activating a back-up section 444 election—(A) Partnerships and S corporations—(1) In general.* A back-up section 444 election made by a partnership or S corporation is activated by filing the return required in § 1.7519-2T (a)(2)(i) and making the payment required in § 1.7519-1T. The due date for filing such return and payment will be the later of—

(i) The due dates provided in § 1.7519-2T, or

(ii) 60 days from the date the Commissioner denies the business purpose request.

However, interest will be assessed (at the rate provided in section 6621 (a)(2)) on any required payment made after the due date (without regard to any extension for a back-up election) provided in § 1.7519-2T (a)(4)(i) or (a)(4)(ii), whichever is applicable, for such payment. Interest will be calculated from such due date to the date such amount is actually paid. Interest assessed under this paragraph will be separate from any required payments. Thus, interest will not be subject to refund under § 1.7519-2T.

(2) *Special rule if Form 720 used to satisfy return requirement.* If, pursuant to § 1.7519-2T (a)(3), a partnership or S corporation must use Form 720, "Quarterly Federal Excise Tax Return," to satisfy the return requirement of § 1.7519-2T (a)(2), then in addition to following the general rules provided in § 1.7519-2T, the partnership or S corporation must type or legibly print the words "ACTIVATING BACK-UP ELECTION" on the top of Form 720. A partnership or S corporation that would otherwise file a Form 720 on or before the date specified in paragraph (b)(4)(iii)(A)(I) of this section may satisfy the return requirement by including the necessary information on such Form 720. Alternatively, such partnership or S corporation may file an additional Form 720 (i.e., a Form 720 separate from the Form 720 it would otherwise file). Thus, for example, if the due date for activating an S corporation's back-up election is November 15, 1988, and the S corporation must file a Form 720 by October 31, 1988, to report manufacturers excise tax for the third quarter of 1988, the S corporation may use that Form 720 to activate its back-up election. Alternatively, the S corporation may file its regular Form 720 that is due October 31, 1988, and file an additional Form 720 by November 15, 1988, activating its back-up election.

(B) *Personal service corporations.* A back-up section 444 election made by a personal service corporation is activated by filing Form 8716 with the personal service corporation's original or amended income tax return for the taxable year in which the election is first

effective, and typing or legibly printing the words—"ACTIVATING BACK-UP ELECTION" on the top of such income tax return.

(iv) *Examples.* The provisions of this paragraph (b)(4) may be illustrated by the following examples. Also see example (2) in paragraph (b)(3) of this section.

Example (1). E, a partnership that historically used a June 30 taxable year, requested (pursuant to section 6 of Rev. Proc. 87-32, 1987-28 I.R.B. 14) permission from the Commissioner to retain a June 30 taxable year for its taxable year beginning July 1, 1987. Furthermore, E is qualified to make a section 444 election to retain a June 30 taxable year for its taxable year beginning July 1, 1987. However, as of the date specified in paragraph (b)(2) of this section, the Commissioner has not determined whether E has a valid business purpose for retaining its June 30 taxable year. Based on these facts, E may, by the date specified in paragraph (b)(2) of this section, make a back-up section 444 election to retain its June 30 taxable year.

Example (2). The facts are the same as in example (1). In addition, on August 12, 1988, the Internal Revenue Service notifies E that its business purpose request is denied. E asks for reconsideration of the Service's decision, and the Service sustains the original denial on September 30, 1988. Based on these facts, E must activate its back-up section 444 election within 60 days after September 30, 1988.

Example (3). The facts are the same as in example (1), except that E desires to make a section 444 election to use a year ending September 30 for its taxable year beginning July 1, 1987. Although E qualifies to make a section 444 election to retain its June 30 taxable year, E may make a back-up section 444 election for a September 30 taxable year.

(c) *Administrative relief—(1) Extension of time to file income tax returns—(i) Automatic extension.* If a partnership, S corporation, or personal service corporation makes a section 444 election (or does not make a section 444 election, either because it is ineligible or because it decides not to make the election, and therefore changes to its required taxable year) for its first taxable year beginning after December 31, 1986, the due date for filing its income tax return for such year shall be the later of—

(A) The due date established under—

(1) Section 6072, in the case of Form 1065,

(2) § 1.6037-1 (b), in the case of Form 1120S,

(3) Section 6072 (b), in the case of other Form 1120 series form; or

(B) August 15, 1988.

The words "SECTION 444 RETURN" should, in order to allow the Service to process the affected returns in an efficient manner, be typed or legibly printed at the top of the Form 1065 or Form 1120 series form, whichever is applicable, filed under this paragraph (c)(1)(i).

(ii) *Additional extensions.* If the due date of the income tax return for the first taxable year beginning after December 31, 1986, extended as provided in paragraph (c)(1)(i)(B) of this section, occurs before the date that is 6 months after the date specified in paragraph (c)(1)(i)(A) of this section, the partnership, S corporation, or personal service corporation may request an additional extension or extensions of time (up to 6 months after the date specified in paragraph (c)(1)(i)(A) of this section) to file its income tax return for such first taxable year. The request must be made by the later of the date specified in paragraph (c)(1)(i)(A) or (c)(1)(i)(B) of this section and must be made on Form 7004, "Application for Automatic Extension of Time To File Corporation Income Tax Return", or Form 2758, "Application for Extension of Time to File U.S. Partnership, Fiduciary, and Certain Other Returns," whichever is applicable, in accordance with the form and its instructions. In addition, the following words should be typed or legibly printed at the top of the form—"SECTION 444 REQUEST FOR ADDITIONAL EXTENSION."

(iii) *Examples.* The provisions of paragraph (c)(1) of this section may be illustrated by the following examples.

Example (1). G, a partnership that historically used a January 31 taxable year, makes a section 444 election to retain such year for its taxable year beginning February 1, 1987. Absent paragraph (c)(1)(i) of this section, G's Form 1065 for the taxable year ending January 31, 1988, is due on or before May 15, 1988. However, if G types or legibly prints "SECTION 444 RETURN" at the top of Form 1065 for such year, paragraph (c)(1)(i) of this section automatically extends the due date of such return to August 15, 1988.

Example (2). The facts are the same as in example (1), except that G desires to extend the due date of its income tax return for the year ending January 31, 1988, to a date beyond August 15, 1988. Pursuant to paragraph

(c)(1)(ii) of this section, G may extend such return to November 15, 1988 (*i.e.*, the date that is up to 6 months after May 15, 1988, the normal due date of the return). However, in order to obtain this additional extension, G must file Form 2758 pursuant to paragraph (c)(1)(i) of this section on or before August 15, 1988.

Example (3). H, a partnership that historically used a May 31 taxable year, makes a section 444 election to use a year ending September 30 for its taxable year beginning on June 1, 1987. Absent paragraph (c)(1)(i) of this section, H's Form 1065 for the taxable year beginning June 1, 1987, and ending September 30, 1987, is due on or before January 15, 1988. However, if H types or legibly prints "SECTION 444 RETURN" at the top of Form 1065 for such year, paragraph (c)(1)(i) of this section automatically extends the due date of such return to August 15, 1988.

Example (4). The facts are the same as in example (3), except H desires to further extend (*i.e.*, extend beyond August 15, 1988) the due date of its income tax return for its taxable year beginning June 1, 1987, and ending September 30, 1987. Since August 15, 1988, is 6 months or more after the due date (without extensions) of such return, paragraph (c)(1)(ii) of this section prevents H from further extending the time for filing such return.

Example (5). I, a partnership that historically used a June 30 taxable year, considered making a section 444 election to retain such taxable year, but eventually decided to change to a December 31, taxable year (I's required taxable year). Absent paragraph (c)(1)(i) of this section, I's Form 1065 for the taxable year beginning July 1, 1987, and ending December 31, 1987, is due on or before April 15, 1988. Pursuant to paragraph (c)(1)(i) of this section, if I types or legibly prints "SECTION 444 RETURN" at the top of Form 1065 for such year, paragraph (c)(1)(i) of this section automatically extends the due date of such return to August 15, 1988. In addition, I may further extend such return pursuant to paragraph (c)(1)(ii) of this section.

(2) *No penalty for certain late payments—(i) In general.* In the case of a personal service corporation or S corporation described in paragraph (c)(1)(i) of this section, no penalty under section 6651 (a)(2) will be imposed for failure to pay income tax (if any) for the first taxable year beginning after December 31, 1986, but only for the period beginning with the last date for payment and ending with the later of the date specified in paragraph (c)(1)(i) or paragraph (c)(1)(ii) of this section.

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(ii) *Example.* The provisions of paragraph (c)(2)(i) of this section may be illustrated by the following example.

Example. J, a personal service corporation that historically used a January 31 taxable year, makes a section 444 election to retain such year for its taxable year beginning February 1, 1987. The last date (without extension) for payment of J's income tax (if any) for its taxable year beginning February 1, 1987, is April 15, 1988. However, under paragraph (c)(2)(i) of this section, no penalty under section 6651(a)(2) will be imposed on any underpayment of income tax for the period beginning April 15, 1988 and ending August 15, 1988.

(d) *Effective date.* This section is effective for taxable years beginning after December 31, 1986.

[T.D. 8205, 53 FR 19703, May 27, 1988]

§ 1.444-4T Tiered structure (temporary).

(a) *Electing small business trusts.* For purposes of § 1.444-2T, solely with respect to an S corporation shareholder, the term *deferral entity* does not include a trust that is treated as an electing small business trust under section 1361(e). An S corporation with an electing small business trust as a shareholder may make an election under section 444. This paragraph (a) is applicable beginning December 29, 2000, however taxpayers may voluntarily apply it to taxable years of S corporations beginning after December 31, 1996.

(b) *Certain tax-exempt trusts.* For purposes of § 1.444-2T, solely with respect to an S corporation shareholder, the term *deferral entity* does not include a trust that is described in section 401(a) or section 501(c)(3) that is exempt from taxation under section 501(a). An S corporation with a trust that is described in section 401(a) or section 501(c)(3) that is exempt from taxation under section 501(a) as a shareholder may make an election under section 444. This paragraph (b) is applicable beginning December 29, 2000, however taxpayers may voluntarily apply it to taxable years of S corporations beginning after December 31, 1997.

[T.D. 8915, 65 FR 82927, Dec. 29, 2000]

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METHODS OF ACCOUNTING

METHODS OF ACCOUNTING IN GENERAL

§ 1.446-1 General rule for methods of accounting.

(a) *General rule.* (1) Section 446(a) provides that taxable income shall be computed under the method of accounting on the basis of which a taxpayer regularly computes his income in keeping his books. The term "method of accounting" includes not only the overall method of accounting of the taxpayer but also the accounting treatment of any item. Examples of such over-all methods are the cash receipts and disbursements method, an accrual method, combinations of such methods, and combinations of the foregoing with various methods provided for the accounting treatment of special items. These methods of accounting for special items include the accounting treatment prescribed for research and experimental expenditures, soil and water conservation expenditures, depreciation, net operating losses, etc. Except for deviations permitted or required by such special accounting treatment, taxable income shall be computed under the method of accounting on the basis of which the taxpayer regularly computes his income in keeping his books. For requirement respecting the adoption or change of accounting method, see section 446(e) and paragraph (e) of this section.

(2) It is recognized that no uniform method of accounting can be prescribed for all taxpayers. Each taxpayer shall adopt such forms and systems as are, in his judgment, best suited to his needs. However, no method of accounting is acceptable unless, in the opinion of the Commissioner, it clearly reflects income. A method of accounting which reflects the consistent application of generally accepted accounting principles in a particular trade or business in accordance with accepted conditions or practices in that trade or business will ordinarily be regarded as clearly reflecting income, provided all items of gross income and expense are treated consistently from year to year.

(3) Items of gross income and expenditures which are elements in computation of taxable income need not be