

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

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

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

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

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

(a) *In general.* Except as otherwise provided, this section applies to any person using an accrual method of accounting with respect to amounts to be received from the performance of services by such person. This section applies to such persons regardless of whether such persons changed their

method of accounting from the cash method under section 448. For example, this section applies to a taxpayer who used an overall accrual method of accounting in taxable years prior to 1987.

(b) *Nonaccrual-experience method; treatment as method of accounting.* Any person to whom this section applies is not required to accrue any portion of amounts to be received from the performance of services which, on the basis of experience, will not be collected. This nonaccrual of amounts to be received for the performance of services shall be treated as a method of accounting under the Code (the nonaccrual-experience method).

(c) *Method not available if interest charged on amounts due—(1) In general.*

The 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, interest or penalties for late payment will be deemed to be charged by a taxpayer if such treatment is in accordance with the economic substance of a transaction, regardless of the characterization of the transaction 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 (i) the full amount due is otherwise accrued as gross income by the taxpayer at the time the services are provided, and (ii) the discount for early payment is treated as an adjustment to gross income in the year of payment, if payment is received within the time required for allowance of such discount.

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

*Example.* X uses an accrual method of accounting for amounts to be received from the provision of services. For such amounts, X has two billing methods. Under one method, for amounts that are more than 90 days past due, X charges interest at a market rate until such amounts (together with interest) are paid. Under the other billing method, X charges no interest for amounts past due. X cannot use the 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. X 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.

(d) *Method not available for certain receivables.* The nonaccrual-experience method of accounting may be used only with respect to amounts earned by the taxpayer and otherwise recognized in income (an account receivable) through the performance of services by such taxpayer. For example, the 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 (1) lending money; (2) selling goods; or (3) acquiring receivables or other rights to receive payment from other persons (including persons related to the taxpayer) regardless of whether those other persons earned such amounts through the provision of services.

(e) *Use of experience to estimate uncollectible amounts—(1) In general.* In determining the portion of any amount due which, on the basis of experience, will not be collected, the formula prescribed by paragraph (e)(2) of this section shall be used by the taxpayer with respect to each separate trade or business of the taxpayer. No other method or formula may be used by a taxpayer in determining the uncollectible amounts under this section.

(2) *Six-year moving average—(i) General rule.* For any taxable year the uncollectible amount of a receivable is the amount of that receivable which bears the same ratio to the account receivable outstanding at the close of the taxable year as (A) the total bad debts (with respect to accounts receivable) sustained throughout the period consisting of the taxable year and the five preceding taxable years (or, with the approval of the Commissioner, a shorter period), adjusted for recoveries of bad debts during such period, bears to (B) the sum of the accounts receivable earned throughout the entire six (or fewer) taxable year period (i.e., the total amount of sales resulting in accounts receivable) throughout the period. Accounts receivable described in paragraphs (c) and (d) of this section

are not taken into account in computing the ratio.

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

(iii) *Special rule for new taxpayers.* In the case of any current taxable year which is preceded by less than 5 taxable years, paragraph (e)(2)(i) of this section shall be applied by using the experience of the current year and the actual number of preceding taxable years. However, for this purpose, experience from preceding taxable years of a predecessor trade or business may be used in applying paragraph (e)(2)(i) of this section.

(3) *Mechanics of nonaccrual-experience method.* The nonaccrual-experience method shall be applied with respect to each account receivable of the taxpayer which is eligible for such method. With respect to a particular account receivable, the taxpayer will determine, in the manner prescribed in

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paragraph (e) of this section, the amount of such account receivable that is not expected to be collected. Such determination shall be made only once with respect to each account receivable, regardless of the term of such receivable. The estimated uncollectible amount shall not be recognized as gross income. Thus, the amount recognized as gross income shall be the amount that would otherwise be recognized as gross income with respect to the account receivable, less the amount which is not expected to be collected. Upon the collection of the account receivable, additional gross income shall be recognized with respect to the collection of any amount not initially expected to be collected. Similarly, no bad debt deduction under section 166 for a wholly or partially worthless account receivable shall be allowed for any amount not previously taken into income under the non-accrual-experience method.

(4) *Examples.* The following examples illustrate the provisions of paragraph (e) of this section:

*Example (1).* X is a calendar year service provider that uses an accrual method of accounting with respect to the amounts (accounts receivable) to be received from the provision of services. X does not require the payment of interest or penalties with respect to past due accounts receivable. Assume that under this section, X adopts for taxable year 1987 the nonaccrual-experience method of accounting with respect to its accounts receivable. Further, assume that X's total accounts receivable and bad debt experience for the current and five preceding taxable years is as follows:

Years	Total accounts receivable	Bad debts adjusted for recoveries
1982 .....	\$30,000	\$5,700
1983 .....	40,000	7,200
1984 .....	50,000	11,000
1985 .....	60,000	10,200
1986 .....	70,000	14,000
1987 .....	80,000	16,800
	330,000	64,900

Thus, the ratio of the bad debts (adjusted for recoveries) for the current and five preceding taxable years to the total accounts receivable over the same period is 19.67% (\$64,900/\$330,000). Assume that \$49,300 of the total \$80,000 of accounts receivable earned throughout the taxable year 1987 are outstanding as of the close of such year. Assume further that the \$49,300 of the accounts re-

ceivable outstanding as of the close of the tax year 1987 consist of 10 separate accounts receivable. The uncollectible amount of each receivable is 19.67%. The amount of these accounts receivable and the uncollectible amount of each is as follows:

	Accounts receivable	Applicable ratio	Uncollectible amount
1.	\$5,200	.1967	\$1,022.84
2.	7,300	.1967	1,435.91
3.	3,200	.1967	629.44
4.	4,300	.1967	845.81
5.	1,700	.1967	334.39
6.	4,000	.1967	786.80
7.	6,300	.1967	1,239.21
8.	8,000	.1967	1,573.60
9.	3,200	.1967	629.44
10.	6,100	.1967	1,199.87
	49,300		9,697.31

For taxable year 1987, X will not accrue as income \$9,697.31 of its accounts receivable of \$49,300 outstanding as of the close of the year.

*Example (2).* The facts are the same as in example (1). In 1988 the entire amount of account receivable number 8 becomes wholly worthless. Since in 1987 X did not accrue as income under the nonaccrual-experience method \$1,573.60 of that account receivable, no deduction under section 166 is allowable with respect to that amount of the account receivable; a deduction of \$6,426.40 under section 166 is allowable for 1988.

*Example (3).* The facts are the same as in example (1). In 1988 X collects, in full, account receivable number 5. Accordingly, in 1988 X must recognize additional gross income of \$334.39, the amount of the account receivable that was initially considered uncollectible.

(5) *Special rule for estimated tax.* For purposes of section 6654 or 6655 only (relating to the addition to tax for underpayment of estimated tax), a taxpayer's income does not include eligible income attributable to the period before May 16, 1988. A taxpayer's eligible income is the excess (if any) of—

(i) Income (including the amount of any adjustment required under section 481(a)) computed with a bad debt experience ratio using accounts receivable earned throughout the period ending at the close of the six-year period (or other shorter period) described in paragraph (e)(2)(i) of this section, over

(ii) Income (including the amount of any adjustment required under section

481(a)) computed with a bad debt experience ratio using the year-end balances of accounts receivable over such six-year (or other shorter) period.

(f) [Reserved]

(g) *Coordination of change in accounting method with section 481—(1) Taxpayers required to change their method of accounting under section 448.* The provisions of this paragraph (g)(1) apply to taxpayers who under §1.448-1T(h) change from the cash method as required by section 448 and who also change under paragraph (h) of this section to a method of accounting that includes the nonaccrual-experience method. With respect to such taxpayers, the section 481(a) adjustment resulting from the change in method of accounting to the nonaccrual-experience method shall be combined or netted with the section 481(a) adjustment applicable to the change in method of accounting required under section 448. The resulting amount shall then be taken into account in accordance with the provisions of §1.448-1T(g) applicable to the change in method of accounting required by section 448.

(2) *Taxpayers not required to change their method of accounting under section 448.* The provisions of this paragraph (g)(2) apply to taxpayers who are not required by section 448 to change their method of accounting (*e.g.*, taxpayers who were using an accrual method of accounting for taxable years preceding 1987) and who change to the nonaccrual-experience method under paragraph (h)(3) of this section. With respect to such taxpayers, the section 481(a) adjustment resulting from the change in method of accounting to the nonaccrual-experience method shall be taken into account ratably over four taxable years. The provisions of this paragraph (g)(2) shall apply to any taxpayer regardless of whether such taxpayer was required to change its method of accounting for bad debts under section 805 of the Tax Reform Act of 1986.

(h) *Changes in method of accounting to nonaccrual-experience method—(1) Automatic changes to overall accrual method.* The provisions of this paragraph (h)(1) apply to taxpayers who change from the cash method as required by section 448, and change to an overall accrual

method of accounting under the automatic change provisions of §1.448-1T(h)(2). Taxpayers to whom this paragraph (h)(1) applies may automatically change their method of accounting to the nonaccrual-experience method under this paragraph (h)(1), if they otherwise qualify under this section for the use of such method. Taxpayers changing to the nonaccrual-experience method under this paragraph (h)(1) shall comply with the provisions of §1.448-1T(h)(2). Moreover, such taxpayers shall type or legibly print the following statement at the top of page 1 of Form 315: “Automatic Change to Nonaccrual Experience Method—Section 448.” The consent of the Commissioner to the change in method of accounting is granted to taxpayers changing to the nonaccrual-experience method under this paragraph (h)(1).

(2) *Changes to a method other than overall accrual method.* The provisions of this paragraph (h)(2) apply to taxpayers who change from the cash method as required by section 448 and who also change to a permissible special method of accounting under §1.448-1T(h)(3). Taxpayers to whom this paragraph (h)(2) applies may change their method of accounting to the nonaccrual-experience method under this paragraph (h)(2). Taxpayers changing to the nonaccrual-experience method under this paragraph (h)(2) shall comply with the provisions of §1.448-1T(h)(3). Moreover, such taxpayers shall type or legibly print the following statement on the top of page 1 of Form 3115: “Change to Nonaccrual-Experience Method and Special Method of Accounting—Section 448.” The consent of the Commissioner to the change in method of accounting is granted to taxpayers changing to the nonaccrual-experience method under this paragraph (h)(2).

(3) *Taxpayers not required to change their method of accounting under section 448.* The provisions of this paragraph (h)(3) apply to taxpayers who are not required by section 448 to change their method of accounting for the taxable year in which such taxpayers desire to adopt the nonaccrual-experience method (*e.g.*, taxpayers who were using an

accrual method of accounting for taxable years preceding 1987). Such taxpayers may automatically change their method of accounting to the non-accrual-experience method under the provisions of this paragraph (h)(3), for their taxable year beginning in 1987, if they otherwise qualify under the provisions of this section for the use of such method. Taxpayers changing to the nonaccrual-experience method for their taxable year beginning in 1987 shall complete and file a current Form 3115. The Form 3115 shall be filed no later than the due date (including extension) of the taxpayer's federal income tax return for the year of change and shall be attached to that return. Moreover, the taxpayer shall type or legibly print the following statement at the top of page 1 of Form 3115: "Automatic Change to Nonaccrual Experience Method—Taxpayer not Required to Change Method of Accounting Under Section 448." The consent of the Commissioner to the change in method of accounting is granted to taxpayers changing to the nonaccrual-experience method for their taxable year beginning in 1987 under this paragraph (h)(3). With respect to taxpayers described in this paragraph (h)(3) who desire to change to the non-accrual-experience method for a taxable year beginning after December 31, 1987, such taxpayers shall submit an application for change in accounting method under the administrative procedures applicable to taxpayers at the time of change, including the applicable procedures regarding the time and place of filing the application for change in method. Taxpayers described in the preceding sentence include taxpayers who were required to change their method of accounting under section 448 for an earlier taxable year, but who did not change to the nonaccrual-experience method at that time.

(i) *Effective date.* This section applies to any taxable year beginning after December 31, 1986.

[T.D. 8143, 52 FR 22774, June 16, 1987, as amended by T.D. 8194, 53 FR 12513, Apr. 15, 1988]

TAXABLE YEAR FOR WHICH ITEMS OF  
GROSS INCOME INCLUDED

**§ 1.451-1 General rule for taxable year of inclusion.**

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