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Article

Like a Hot Knife Through Butter: The US Congress and Internal Revenue Service Pierce Straight Through Barrier Options

By Mark Leeds[1]

The author and his reviewer each find themselves raising teenage girls, coincidentally attending the same school. Readers with teenagers of their own may recognize that, sometimes, concerned parents may find themselves with surprisingly little leverage over a particularly important issue on which our young women may have a contrary view: e.g., home before midnight, studying the night before a test or even studying at all. We both have found that when we can't influence the issue that we desire to control, applying pressure on a seemingly unrelated front over which we do have some sway may change behavior on the "big" issue.

The US Congress and the Internal Revenue Service (the "IRS") have been applying a similar technique with hedge funds and their principals who have entered into barrier call options. After finding that a direct attack on the option transactions did not result quickly enough in denying the tax benefits associated with these option transactions, Congress and the IRS have resorted to public shaming and using the accounting method rules to reach the transactions. It is curious that the IRS took this tack instead of designating the barrier option transaction as a listed transaction or a transaction of interest.

AM 2010-005—Dad, That is *So* 2010

In AM 2010-005, released on November 12, 2010, the IRS considered the following call option contract. HF, a United States partnership entered into a two-year call option contract with a publicly traded United Kingdom bank ("Bank"). HF is described as a hedge fund manager. The property referenced by the call option is a so-called "managed account." A managed account is a brokerage account maintained by the Bank into which a number of stock (and possibly commodities and derivatives) positions are placed. The Advice Memorandum refers to the contents of the managed account as the "Reference Basket." At the inception of the option, the value of the managed account was $10x. HF paid a $1x premium for the option. AM 2010-005 recites that the option premium was not determined with reference to options pricing models and economically was reimbursed upon a cash settlement of the option.

In AM2010-005, the IRS concluded that the option was a disguised leveraged purchase of the positions that were subject to option. As a result, the IRS held that the optionee should be subject to current tax on the income and gains from the securities underlying the option transaction. If option treatment had prevailed, the optionee would have enjoyed deferral and conversion of ordinary income and short-term capital gains into long-term capital gains. We explored the technical basis for the IRS's position in detail in an earlier article.[2] Based upon the developments discussed below, the substantive attack on

barrier option transactions was just the first step in addressing the use of these types of options.

The Senate Subcommittee Report (Respond with Full Eye Roll & Heavy Sigh)

On July 22, 2014, the US Senate Permanent Subcommittee on Investigations held a hearing on the "Abuse of Structured Financial Products: Misusing Basket Options to Avoid Taxes and Leverage Limits." In connection with the hearing, the Committee Staff prepared a report (the "Senate Basket Option Report" or the "Report"). The Senate Basket Option Report begins by naming two international banks that sold option products similar to the one described in AM2010-005 and two hedge funds that purchased such options. The Senate Basket Option Report provided a scathing indictment of the product and the market participants that entered into these transactions.

DAD, CAN I HAVE A LITTLE PRIVACY *PLEASE*?

Before exploring the Senate Basket Option Report itself, it is worth pausing to consider the extent to which the public shaming of the parties named in the Report constituted a violation of their right to privacy. The Privacy Act[3] provides that, subject to enumerated exceptions, no federal agency, including the IRS, may disclose any record which is contained in its system of records, unless the individual to whom the record applies gives the agency consents to make that disclosure. In addition, Section 6103(a) of the Internal Revenue Code of 1986, as amended (the "Code"), provides that the IRS may not disclose taxpayer tax return information except as provided by that Code section. Code § 6103(f)(3) allows the IRS to turn over tax return information to a Congressional Committee[4] only if the Senate or the House of Representatives (the "House") by resolution (i) has authorized the Committee to obtain such information and (ii) specified the purpose for which the information is to be furnished. Even if Congress has passed such a resolution, the information may be disclosed only if the Committee is sitting in a closed legislative session.

Congress did not pass a resolution authorizing the Senate Subcommittee on Investigations to obtain taxpayer information. Nonetheless, the Senate Basket Option Report specifically states that the Subcommittee "gathered documents, obtained information and received briefings from a number of federal agencies and related parties." The Senate Basket Option Report states that the agencies "cooperated with the Subcommittee Requests for information." The Subcommittee also obtained documents from the banks involved, the hedge funds and their accountants as well as interviewing individuals associated with each company. There is not enough information provided in the Senate Basket Option Report to determine whether any taxpayer privacy rules were violated.

The Senate Option Basket Report contains a full description of a current audit of a taxpayer. Regardless of whether taxpayer privacy rights were violated, the use of names in the Report is troublesome. The "naming of names" is a public denunciation of a financial product that has not been reviewed by any court and involves taxpayers currently under IRS audit. The Senate Basket Option Report is clearly intended to affect how the IRS should resolve the audits. At best, one can reasonably ask whether this is a fair and impartial administration of the federal income tax laws.

THE OPTION TRANSACTION DESCRIBED IN THE SENATE REPORT (*FACT!*)

The Senate Basket Option Report addresses three-year American-style call options issued to hedge funds. The option related to unspecified securities held within a designated account. The account was maintained in the name of the bank that wrote the option. The terms of the option contained certain minimal parameters on the securities that could be held in the account. The hedge fund paid an option premium of 10

percent of the value of the assets held in the account. The bank took that premium and added its own funds (90 percent of the value of the account) to the account. The general partner of the hedge fund was appointed to invest the account proceeds. As a general matter, the trading in the account generated short-term capital gains and other types of ordinary income. In the hands of an individual, these gains and income would have been taxable at ordinary income rates.

Under the terms of the options, if losses in the account came close to 10 percent of the initial value of the account, the option "knocked out." (The knock-out feature is sometimes referred to as a barrier, hence the name of the options as barrier options.) The optionees generally exercised the options shortly after the options had been outstanding for the long-term capital gain holding period, more than one year during the years under investigation. The optionees claimed that the gains from the terminations of the options were long-term capital gains, taxable at a favorable rate.

Based upon the finding of facts described above, coupled with the tax reporting by the hedge funds involved, the Senate Basket Option Report concludes that the option transactions should not be respected as options for federal income tax purposes. The Report concludes that the banks were "aware of the questionable tax status of their basket option structures for many years prior to the issuance of the 2010 IRS advisory memorandum, but continued to sell the product." The Report recommended that the IRS assert the result described in AM2010-005 against the hedge funds that entered into the option transactions.

CCA 201426025—The Accounting Method Issue Is Raised

Following the issuance of AM 2010-005 and the Senate Basket Option Report, one could reasonably have thought that everything that could have gone wrong had happened. But things took a turn for the worse with the issuance of CCA 201426025 (Jan. 17, 2014).[5] The most interesting facts underlying CCA 20146025 are not mentioned anywhere in the CCA itself. The actual fight appears to have revolved around a statute of limitations issue, penalties and interest. Specifically, it appears that the year in which a hedge fund entered into a barrier option was closed by reason of the expiration of the statute of limitations on assessment.[6] In order to avoid this limitation[7] and be able to impose penalties and interest on the deficiency resulting from the change from option treatment to ownership transaction, the IRS argued that a change in accounting method occurred when the hedge fund changed its method of accounting for the barrier options. This would enable the IRS to place the entire adjustment in a single year that was open to assessment.

The IRS may change a taxpayer's method of accounting if the chosen method does not clearly reflect income.[8] The IRS's discretion to do so is limited to those items that would constitute a change in accounting method if the change had been initiated by the taxpayer.[9] A change in accounting method includes a change in the overall plan of accounting for gross income or deductions or a change in the treatment of any material item used in such overall plan.[10] Therefore, if the treatment of the options as ownership transactions constitutes a change in accounting method, the taxpayer generally would be required to file a change in accounting method request (Form 3115) with the IRS in order to effectuate such change.

The accounting method for material items involves the proper *time* for the inclusion of an item in income or the taking of a deduction.[11] Thus, the focus of the accounting method change rules is solely on the timing of income and deductions. If the change affects a permanent difference in a taxpayer's "lifetime" income, then it is not a change in accounting method.[12] In contrast, if the change involves the year in which an item is reported, it will be treated as an

accounting method.[13] As described below, even certain changes in the timing of an item, however, are exempted from being considered changes in accounting methods.

As we see below, two of three sets of potentially applicable authorities support the position of the taxpayer that treating the options as ownership transactions did not constitute a change in accounting method. The IRS did not even mention the "change in facts" authorities that favored the taxpayer. Of even more concern, however, is the fact that the IRS found several reasons to simply ignore a body of law (the divergence authorities) that clearly favored the taxpayer's position that no change in accounting method occurred. CCA 201426025 is so results-oriented that it reads like a litigation brief in a highly contested matter. It seems clear to the authors that the CCA has nothing to do with a change in accounting method. It appears to be a blunderbuss attack by the IRS in its quest to avoid statute of limitations issues and impose penalties on the taxpayer for its initial treatment of the barrier option transactions.

CHANGE IN FACTS

A change in accounting method does not include a change in treatment resulting from a change in the underlying facts.[14] In *Decision, Inc. v. Comm'r*,[15] the Tax Court refused to treat the taxpayer's change in billing policy as a change in accounting method. The court found that although the change had consequences in the annual determination of income, such consequences were not produced by the accounting system. Moreover, the court colorfully noted that the "kind of business policy change was no different from a decision to lower prices or halt production for a year" and to hold that the taxpayer changed its method of accounting as a result of that "would have the effect of denying a business the right to determine the terms of sale of its product without clearing the matter with the Commissioner ... clearly an odious propagation of the tentacles of the Government anemone."[16]

In another instance, the IRS has held that the change-in-facts exception includes a change in the procedure for determining when a loan becomes worthless.[17] In Treasury Regulation § 1.446-1(e)(2)(iii), Example 4, the IRS held that a taxpayer is allowed to change the ratio used to allocate indirect overhead costs to the value of inventories based on a change in underlying facts. The example holds that if the taxpayer is able to demonstrate that the ratio of indirect costs to direct costs has in fact increased, the change in treatment is permitted without IRS consent. Thus, the underlying fact that has changed was the increase in overhead costs.

In FSA 200129003, the taxpayer was a thrift institution described in Code § 7701(a)(19) and used the reserve method described in Code § 593 to account for its bad debt losses. For financial and regulatory purposes, the taxpayer recorded mortgage loans under a single account ("Account 1") but separately recorded specific and general loan reserves on its books as contra assets to this account ("Contra-Account 1"). Upon foreclosure, the taxpayer would transfer the related real estate loan from Account 1 to an REO account ("Account 2"). The taxpayer, for book purposes, would also record specific and general reserves with respect to its REO property in Account 2 by recording the reserve in another account ("Account 3"), captioned "Loss on Real Estate." For financial and regulatory purposes, the taxpayer would also establish general reserves against the inherent risk associated with making loans.

For federal income tax purposes, the taxpayer had charged off as losses against its tax reserves for: (i) specific write-offs related to loans sold to third parties and certain short payoff loans; (ii) write-offs on specific foreclosed property; and (iii) write-offs of delinquent interest. In tax year 3, in addition to the above three types of charge-offs, the taxpayer had charged off as losses against its tax reserves amounts for:

(i) write-downs to net realizable value; (ii) losses recognized on the transfer of reserves from general to specific reserves for loans in Account 1; (iii) losses recognized on the transfer of reserves from general to specific reserves for foreclosed property in Account 2; (iv) losses attributable to private mortgage insurance; (v) write-offs in Account 2 (to establish reserves); and (vi) reverse reserves foreclosed.

The taxpayer took the position that, as it was within its discretion whether to recognize losses attributable to partial worthlessness, its conduct in the subsequent tax year did not amount to a change in method of accounting. The taxpayer observed that the additions of the newly identified items in the subsequent tax year resulted from a change in underlying facts. First, the taxpayer stated that new technology apparently aided the gathering of additional information in a cost-effective manner. This new technology included the "ticking" and "adding up" of different types of entries to the general ledger, introduction of the personal computer, and spreadsheet programs that assisted staff in making possible the required analysis of the general ledger. The taxpayer also stated that it experienced a change in economic conditions along with a change in financial accounting requirements in the subsequent tax year. Additionally, for financial accounting purposes, the taxpayer apparently began experiencing increased realizable losses in such tax year. These changes in circumstances, coupled with increased projected financial losses, apparently required the taxpayer to reconsider its assumptions about how loss reserves should be measured and recorded, and how the existing accounting system should be used and adjusted to deal with the developing economic situation.

The IRS ruled that the changes in the subsequent year "most likely" did not constitute changes in an accounting method. As the IRS observed:

> Section 166 and the regulations thereunder do not preclude a taxpayer that is using the specific charge-off method from claiming a tax deduction attributable to the partial worthlessness of a loan merely because that taxpayer had not taken similar deductions previously. Thus, if the worthlessness of a debt would be considered to have been established by a taxpayer using the specific charge-off method in support of a current tax deduction based on partial worthlessness, then based on the same operative facts a section 593 reserve method taxpayer's charge against its tax reserve should be accepted. We would not foreclose a section 593 reserve method taxpayer from taking a charge-off to its reserve for an otherwise allowable loan loss based on partial worthlessness merely because it has not established such a practice in the past. The crucial determination in both situations is whether the taxpayer has established a currently recognizable loss based on partial worthlessness.

The "change in facts" cases are not acknowledged or discussed by the IRS in CCA 201426025. A substantial position exists that the change in the treatment of the option from being an option to being an ownership transaction is a change in facts. These authorities favor the taxpayer and should be considered in any final evaluation as to whether the change in the treatment of the barrier options from options to ownership transactions constitute a change in accounting method.

CHANGE IN CHARACTERIZATION

While a change in underlying facts may not result in a change in the treatment of a particular item being treated as a change in accounting method, the IRS has been successful in asserting that the change in the characterization of a transaction does result in a change in accounting method. The delineation between a change in underlying facts and a change in the characterization of a transaction is hazy at best. The IRS relied on the change in characterization

authorities to support its assertion that the change in the treatment of the barrier option transactions to ownership transactions constituted a change in accounting method.[18]

In *Cargill, Inc. v. U.S.*,[19] the taxpayer treated as a lease, for federal income tax purposes, a transaction pursuant to which it leased a terminal facility in Portland, Oregon. Accordingly, the taxpayer deducted the lease payments as rent. After a further review of the transaction, the taxpayer determined that the lease transaction should be characterized as a debt instrument and the taxpayer should be treated as the owner of the terminal, for tax purposes. After making such determination, the taxpayer sought to treat itself as the owner of the terminal, deducting depreciation, interest expense and other costs associated with operating the terminal as well as claiming certain tax credits. The IRS asserted that this change could not be made without the approval of the IRS, as the change constituted a change in accounting method.

The court sided with the IRS and held that the change in the characterization of the transaction from lease to ownership constituted a change in accounting method. The court found that there was no such thing as a change-in-characterization exception to a change in accounting method. The court did not even examine whether the totality of the deductions and credits available to the taxpayer as owner would be equivalent to the deductions available if the transaction was characterized as a lease. It held that other cases that found no change in accounting method based upon a change in characterization "even if … not distinguishable, however, … ultimately rest on the erroneous premise that consent is not required if the taxpayer's previous treatment of the item was improper."

The cases treating a change in the characterization of a transaction as a change in accounting method form strong support for the IRS's position that the change in the treatment of the barrier option transactions from options to ownership transactions constitute a change in accounting method. In the case of the barrier options, the only issue is whether the income and gain from these transactions should be deferred and treated as capital or should be recognized currently and treated as ordinary income. There is no issue as to the amount of the income. As is discussed below, however, the taxpayer had a strong defense to the application of these cases on the ground that the failure to treat the options in the same manner as it treats its physical securities positions is simply a divergence from its overall adopted and used method of accounting.

THE DIVERGENCE CASES

A series of cases have held that when a taxpayer diverges from its adopted method of accounting on a particular item, correction of such item is not a change in accounting method.[20] In other words, if a taxpayer has adopted a method of accounting and used it generally, the fact that it did not use it for a particular transaction (usually from inadvertent error) does not mean that the subsequent change to the adopted accounting method for that transaction was a change in accounting method. Because the hedge fund in CCA 201426025 had already adopted an accounting method for its physical securities positions, this rule clearly supports the conclusion that the change in the treatment of the barrier options from options to current ownership of securities should not be treated as a change in accounting method by the taxpayer. The IRS had an unusual way of dealing with this roadblock.

Specifically, the IRS set forth five arguments as to why it should be able to ignore this line of authority. First, interpreting its own regulation[21] as contrary to established case law and enjoying superiority over such case law, the IRS asserted that the regulation should prevail. (It is far from clear that the regulation is even contrary to the cases.) Second, it characterizes the cases as erroneous because it is "overly simplistic" to find

that the "necessary adjustments have not altered the primary accounting method." Third, the IRS disputed the proposition that divergent treatment cannot be a material item because it only applies to a portion of the items subject to the taxpayer's treatment. In the view of the IRS, the only issue is whether the conforming change would affect the timing of the realization of the item. Fourth, the IRS held the divergent treatment cases are incompatible with hybrid accounting methods. In other words, a taxpayer that has not followed its selected method of accounting for a particular item should be considered to have adopted a hybrid method of accounting. As a result, the change to the conforming method of accounting would be a change in accounting method. Last, the IRS dismissed the divergent accounting cases on the ground that it is "highly counterintuitive" that the failure to file an adopted accounting method does not reflect the accounting method that the taxpayer is "really using."

The IRS's dismissal of the divergence cases is troubling. The IRS would have been on a stronger footing if it attempted to justify its position within the parameters of the existing authorities instead of seizing on the cases that supported it and rejecting a complete line of authority that ran against it. As noted above, CCA 201426025 does not appear to be a balanced application of the law to the facts. It reads like the IRS is using the change in accounting method as a tactic to be able to avoid the statute of limitations and to assess penalties.

CCA 201432016—More Accounting Method Attacks

CCA 201432016 provides a follow-on to the change in accounting method analysis contained in CCA 201426025. In CCA 201432016, it is disclosed that the taxpayer (a hedge fund) that entered into the barrier options was a trader in securities that had made an election under Code § 475(f) to use mark-to-market accounting for its securities positions. The CCA also recites that the hedge fund did not use mark-to-market accounting for the barrier options.

The hedge fund stated that it had "misread" Code § 475(f)(3). This Code section requires persons who are traders in securities and traders in commodities to make separate elections for each such trade or business. The taxpayer read it as permitting it to make separate elections for each securities trading trade or business. As a result, the taxpayer believed that it had made a mark-to-market election for its securities trading business that did not extend to its trade or business of holding the barrier option positions. The IRS read, and the taxpayer conceded, that Code § 475(f) encompasses all securities trading businesses undertaken by a taxpayer as being subject to the mark-to-market election.

The IRS's reading of Code § 475(f)(3) seems to be the right reading. In other words, if a person who is a trader in securities makes the election, it should apply to all transactions that are undertaken in the trade or business of being a trader in securities. A securities trader should not be able to hive off certain securities activities and assert that such activities are not governed by its election to use mark-to-market accounting. This conclusion is borne out by the legislative history of Code § 475(f). The House Report accompanying the enactment of the provision explicitly states that "The election is to be made separately with respect to the taxpayer's *entire* business."[22] The Conference Report further provides that "All securities held by an electing taxpayer in connection with a trade or business as a securities trader ... are subject to mark-to-market treatment.

Applicable IRS regulations impose two requirements in order for a trader in securities that has elected mark-to-market accounting to not use mark-to-market accounting for a particular position. First, the taxpayer must specifically identify the position as not being subject to mark-to-market accounting.[23] If a taxpayer fails to identify the security as exempt from mark-to-market accounting, "the character

of the gain or loss with respect to the security is ordinary."[24] Second, the taxpayer must demonstrate "by clear and convincing evidence that the [identified] security has no connection to its trading activities."[25]

In CCA 201432016, the IRS found that the barrier options were held in connection with the taxpayer's business of securities trading. This conclusion seems correct in light of the fact that the taxpayer maintained other trading positions with the financial institution that wrote the barrier options and that its general partner managed the positions underlying the barrier options. The barrier option positions were not identified as held for investment. As noted above, the barrier option transactions did not constitute a separate trade or business from trading in securities generally.

These facts strongly support the conclusion that the taxpayer (a hedge fund) should have recognized ordinary income on a mark-to-market basis from its barrier option transactions. It appears that the taxpayer failed to establish, by both a lack of identification and in fact, that the barrier options should not be subject to its election to use mark-to-market accounting under Code § 475(f). The IRS, however, was not satisfied with this result, even though it appeared to provide the answer that the IRS sought. The answer as to why comes at the end of the discussion in CCA 201432016: "Because of the closed years involved, and because different securities could be and were traded in and out of the baskets ... we are uncertain that this argument picks up the appropriate amount of gains and losses." In all of the discussion in CCA 201426025 and CCA 201432016, this is the only admission that the IRS was seeking to use the change in accounting method analysis as a back door to avoid the statute of limitations constraints on its ability to assess tax.

CCA 201432016 concludes that if the barrier options are recharacterized as ownership transactions, then the hedge fund's ownership of the securities underlying the managed account (basket) that was the subject of the option should be encompassed by the taxpayer's election to use mark-to-market treatment. This result appears correct, if applicable.

Last, CCA 201432016 discusses how the IRS should proceed if it fails in its position that the change from option treatment to ownership is not a change in accounting method. CCA 201432016 properly concludes that the resulting ownership position would be subject to the mark-to-market election. As a result, in years that were not closed by reason of the statute of limitations, all gains and losses would be recognized currently as ordinary. Similarly, the IRS concludes that if it fails both on the recharacterization of the transactions and the change in accounting method assertion, then the options themselves would be accounted for on the mark-to-market method of accounting and the resulting gains and losses would also be ordinary. Again, this also seems correct.

Concluding Observations

Both Congress and the IRS are clearly perturbed that financial institutions offered barrier options and that hedge funds used these transactions as a method of attempting to convert ordinary income and short-term capital gains into long-term capital gains. The IRS has a potent weapon in its arsenal when it confronts a transaction that it believes has a low probability of efficacy and can be used as a tax shelter: It can designate the transaction as a listed transaction or as a reportable transaction.[26] The use of the reportable transaction reporting mechanism frees up IRS resources and allows the IRS to focus on the transaction directly. The use of public shaming and twisting other rules to get at a transaction that the IRS perceives as abusive can have the effect of making a virtuous pursuit of fair administration of the tax laws appear as unprincipled as the abuse that the government is seeking to curtail. ◆

For more information about the topics raised in this article, please contact the author or your regular Mayer Brown contact.

Mark H. Leeds
+1 212 506 2499
mleeds@mayerbrown.com

Endnotes

[1] Mark Leeds is a tax partner in Mayer Brown's New York office and is the editor-in-chief of Derivatives: Financial Products Report, an RIA/Thompson publication. Mark thanks Ed Park for his assistance in developing this article. Ed Park is a managing director with AIG in New York. Mark and Ed will be speaking about the tax issues associated with barrier options at the Wall Street Tax Conference in New York on November 6, 2014. The views expressed herein are solely those of the author and should not be attributed to Mayer Brown.

[2] See Leeds, "Dealer's Choice: AM2010-005 Pierces Option Contract to Find Ownership of Referenced Management Account by Optionee," reprinted in *Daily Tax Report* (December 2, 2010), 230 DTR J-1.

[3] 5 U.S.C. §§ 552a(b)(5), 552a(b). Many federal circuits limit the right of individual taxpayers to sue the IRS for failures to comply with the Privacy Act. See e.g. *Cheek v. IRS*, 703 F.2d 701 (7th Cir. 1983).

[4] Special rules are provided for disclosures to the congressional tax-writing committees, but the Senate Permanent Subcommittee on Investigations is not encompassed by these rules.

[5] It strongly appears that CCA 20140315 (Sep. 10, 2013) also addressed the use of the change in accounting method strategy to circumvent the statute of limitations defense by a hedge fund that entered into barrier option transactions. This CCA addresses whether a change from open transaction accounting to current realization resulting from a change in the characterization of a transaction is a change in accounting method and whether a change in accounting method can take into account closed taxable years.

[6] See CCA 201432016 (Apr. 10, 2014).

[7] See *Suzy's Zoo v. Comm'r*, 114 T.C. 1, 12-13 (2000), aff'd 273 F.3d 875, 884 (9th Cir. 2001); *Huffman v. Comm'r*, 126 T.C. 322, 341-2 (2006), aff'd 518 F.2d 357, 363-4 (6th Cir. 2008); *Graff Chevrolet Co. v. Campbell*, 343 F.2d at 571-572; *Rankin v. Comm'r*, 138 F.3d 1286, 1288 (9th Cir. 1998); *Superior Coach of Florida v. Comm'r*, 80 T.C. 895, 912 (1983); *Weiss v. Comm'r*, 395 F.2d 500 (10th Cir. 1968); *Spang Industries, Inc. v. U.S.*, 6 Cl. Ct. 38, 46 (1984), rev'd on other grounds 791 F.2d 906 (Fed. Cir. 1986).

[8] Code § 446(b); Treas. Reg. § 1.446-1(b)(1).

[9] Rev. Proc. 2002-18, 2002-1 C.B. 676.

[10] Treas. Reg. § 1.446-1(e)(2)(ii)(a).

[11] *FPL Group, Inc. v. Comm'r.*, 115 T.C. 554, 561 (2000) ("The consistent treatment of a recurring, material item, whether that treatment be correct or incorrect, constitutes a method of accounting.").

[12] Rev. Proc. 97-27, 1997-1 C.B. 680, 681, § 2.01(1).

[13] *Id.*

[14] Treas. Reg. § 1.446-1(e)(2)(ii)(b).

[15] 47 T.C. 58, 64 (1966) acq., 1967-2 C.B. 2.

[16] See also *Baltimore & O. R. Co. v. United States*, 221 Ct. Cl. 16 (1979) (A switch to more accurate valuation method is not a change in accounting method).

[17] See *McPike, Inc. v. United States*, 15 Cl. Ct. 94, 99 (1988) ("An accounting method is not a procedure used to learn the facts about a taxpayer's expense but it is the *treatment* of that expense by the taxpayer.") (Emphasis in original.)

[18] See *Pacific Enterprises v. Comm'r*, 101 T.C. 1 (1993); *Witte v. Comm'r*, 513 F.2d 391 (D.C. Cir. 1975); *Diebold Inc. v. U.S.*, 891 F.2d 1579 (Fed. Cir. 1990).

[19] 91 F.Supp.2d 1293 (D.Minn. 2000)

[20] *Gimbel Brothers, Inc. v. U.S.*, 535 F.2d 14 (Ct. Cl. 1976); *Standard Oil v. Comm'r*, 77 T.C. 349 (1981).

[21] Treas. Reg. § 1.446-1(e)(2)(i)

[22] H.R. Rep. 105-148, 105th Cong., 1st Sess. 445 (1997). (Emphasis added.)

[23] Prop. Treas. Reg. § 1.475(f)-2(a).

[24] Prop. Treas. Reg. § 1.475(f)-2(a)(4)(ii).

[25] Prop. Treas. Reg. § 1.475(f)-2(a)(2); see also H.R. Rep. No. 105-220, 105th Cong., 1st Sess. 210 (1997).

[26] See Treas. Reg. § 1.6011-4

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