

Change in Accounting Method for Deferred Compensation

Notice 99-16

This notice provides procedures for implementing a change in method of accounting to comply with § 404(a)(11) of the Internal Revenue Code, regarding the payment of deferred compensation.

Section 404(a)(11) was added to the Code by § 7001 of the Internal Revenue Service Restructuring and Reform Act of 1998 (RRA), Pub. L. No. 105-206, 112 Stat. 685, 827 (July 22, 1998), effective for taxable years ending after July 22, 1998. Section 404(a)(11) provides that, for purposes of determining under § 404 whether compensation of an employee is deferred compensation and when deferred compensation is paid, no amount is treated as received by the employee, or paid, until it is actually received by the employee. Section 404(a)(11) overturns the decision in *Schmidt Baking Co. v. Commissioner*, 107 T.C. 271 (1996), in which the court held that a § 83(a) income inclusion event upon securitization of vacation and severance pay benefits with a letter of credit constitutes receipt of those benefits by employees for purposes of determining whether an employer's deduction for the benefits is subject to § 404.

Section 7001(b) of the RRA provides that a taxpayer changing its method of accounting to comply with § 404(a)(11) for its first taxable year ending after July 22, 1998, will be treated as making a change initiated by the taxpayer with the consent of the Commissioner. It further provides that the change will be made with a § 481 adjustment that will be taken into account ratably over a 3-taxable-year period beginning with the first taxable year ending after July 22, 1998.

A taxpayer changing its method of accounting for its first taxable year ending after July 22, 1998, to comply with § 404(a)(11) must follow the automatic change in accounting method provisions of Rev. Proc. 98-60, 1998-51 I.R.B. 16, with the following modifications:

(1) The scope limitations in section 4.02 of Rev. Proc. 98-60 do not apply.

However, if the taxpayer is under examination, before an appeals office, or before a federal court with respect to any income tax issue, the taxpayer must provide a copy of the Form 3115, Application for Change in Accounting Method, to the examining agent(s), appeals officer, or counsel for the government, as appropriate, at the same time that it files the copy of the Form 3115 with the national office. The Form 3115 must contain the name(s) and telephone number(s) of the examining agent(s), appeals officer, or counsel for the government, as appropriate.

(2) The § 481(a) adjustment period generally is three taxable years (as opposed to four taxable years as specified in section 5.04(1) of Rev. Proc. 98-60).

(3) A taxpayer that, on or before May 28, 1999, files its original federal income tax return for its first taxable year ending after July 22, 1998, may comply with the filing requirement in section 6.02(2)(a) of Rev. Proc. 98-60 or with the following filing requirement. The taxpayer must complete and file a Form 3115 in duplicate. The original must be attached to the taxpayer's amended federal income tax return for the taxpayer's first taxable year ending after July 22, 1998. This amended return must be filed no later than July 27, 1999. A copy of the Form 3115 must be filed with the national office (at the address specified in section 6.02(6) of Rev. Proc. 98-60) no later than when the taxpayer's amended return is filed.

(4) Section 7 of Rev. Proc. 98-60 does not apply; a taxpayer does not receive audit protection in connection with this change.

EFFECT ON OTHER DOCUMENTS

Rev. Proc. 98-60 is modified and amplified to include this automatic accounting method change in the Appendix.

DRAFTING INFORMATION

The principal author of this notice is Robert Testoff of the Office of the Assistant Chief Counsel (Income Tax and Accounting). For further information regarding this notice, contact Mr. Testoff at (202) 622-4800 (not a toll-free call).