

(l) [Reserved]

(m) *Change in method of accounting required by this section*—(1) *In general.* For the first taxable year ending after July 18, 1984, a taxpayer is granted the consent of the Commissioner to change its method of accounting for liabilities to comply with the provisions of this section pursuant to any of the following procedures:

(i) For taxable years ending before April 7, 1995, the part-year change in method election described in Q&A-2 through Q&A-6 and Q&A-8 through Q&A-10 of § 1.461-7T (as it appears in 26 CFR part 1 revised April 1, 1995);

(ii) For taxable years ending before April 7, 1995, the full-year change in method election described in Q&A-2 through Q&A-6 and Q&A-8 through Q&A-10 of § 1.461-7T (as it appears in 26 CFR part 1 revised April 1, 1995); or

(iii) For taxable years ending before April 7, 1995, if no election is made, the cut-off method described in Q&A-1 and Q&A-11 of § 1.461-7T (as it appears in 26 CFR part 1 revised April 1, 1995).

(2) *Change in method of accounting for long-term contracts and payment liabilities*—(i) *First taxable year beginning after December 31, 1991.* For the first taxable year beginning after December 31, 1991, a taxpayer is granted the consent of the Commissioner to change its method of accounting for long-term contract liabilities described in paragraph (D)(2)(ii) of this section and payment liabilities described in paragraph (g) of this section (other than liabilities arising under a workers compensation act or out of any tort described in paragraph (g)(2) of this section) to comply with the provisions of this section. The change must be made in accordance with paragraph (m)(1)(ii) or (m)(1)(iii) of this section, except the effective date is the first day of the first taxable year beginning December 31, 1991.

(ii) *Retroactive change in method of accounting for long-term contracts and payment liabilities.* For the first taxable year beginning after December 31, 1989, or the first taxable year beginning after December 31, 1990, a taxpayer is granted the consent of the Commissioner to change its method of accounting for long-term contract liabilities described in paragraph (d)(2)(ii) of this

section and payment liabilities described in paragraph (g) of this section (other than liabilities arising under a workers compensation act or out of any tort described in paragraph (g)(2) of this section) to comply with the provisions of this section. The change must be made in accordance with paragraph (m)(1)(ii) or (m)(1)(iii) of this section, except the effective date is the first day of the first taxable year beginning after December 31, 1989, or the first day of the first taxable year beginning after December 31, 1990. For taxable years ending before April 7, 1995, the taxpayer may make the change in method of accounting, including a full-year change in method election under paragraph (m)(1)(ii) of this section and Q&A-5 of § 1.461-7T (as it appears in 26 CFR part 1 revised April 1, 1995), by filing an amended return for such year, provided the amended return is filed on or before October 7, 1992.

[T.D. 8408, 57 FR 12421, Apr. 10, 1992, as amended by T.D. 8491, 58 FR 53135, Oct. 14, 1993; T.D. 8593, 60 FR 18743, Apr. 13, 1995; T.D. 8820, 64 FR 26851, May 18, 1999; T.D. 8408, 69 FR 44597, July 27, 2004]

§ 1.461-5 Recurring item exception.

(a) *In general.* Except as otherwise provided in paragraph (c) of this section, a taxpayer using an accrual method of accounting may adopt the recurring item exception described in paragraph (b) of this section as method of accounting for one or more types of recurring items incurred by the taxpayer. In the case of the “other payment liabilities” described in § 1.461-4(g)(7), the Commissioner may provide for the application of the recurring item exception by regulation, revenue procedure or revenue ruling.

(b) *Requirements for use of the exception*—(1) *General rule.* Under the recurring item exception, a liability is treated as incurred for a taxable year if—

(i) As of the end of that taxable year, all events have occurred that establish the fact of the liability and the amount of the liability can be determined with reasonable accuracy;

(ii) Economic performance with respect to the liability occurs on or before the earlier of—

(A) The date the taxpayer files a timely (including extensions) return for that taxable year; or

(B) The 15th day of the 9th calendar month after the close of that taxable year;

(iii) The liability is recurring in nature; and

(iv) Either—

(A) The amount of the liability is not material; or

(B) The accrual of the liability for that taxable year results in a better matching of the liability with the income to which it relates than would result from accruing the liability for the taxable year in which economic performance occurs.

(2) *Amended returns.* A taxpayer may file an amended return treating a liability as incurred under the recurring item exception for a taxable year if economic performance with respect to the liability occurs after the taxpayer files a return for that year, but within 8½ months after the close of that year.

(3) *Liabilities that are recurring in nature.* A liability is recurring if it can generally be expected to be incurred from one taxable year to the next. However, a taxpayer may treat such a liability as recurring in nature even if it is not incurred by the taxpayer in each taxable year. In addition, a liability that has never previously been incurred by a taxpayer may be treated as recurring if it is reasonable to expect that the liability will be incurred on a recurring basis in the future.

(4) *Materiality requirement.* For purposes of this paragraph (b):

(i) In determining whether a liability is material, consideration shall be given to the amount of the liability in absolute terms and in relation to the amount of other items of income and expense attributable to the same activity.

(ii) A liability is material if it is material for financial statement purposes under generally accepted accounting principles.

(iii) A liability that is immaterial for financial statement purposes under generally accepted accounting principles may be material for purposes of this paragraph (b).

(5) *Matching requirement.* (i) In determining whether the matching require-

ment of paragraph (b)(1)(iv)(B) of this section is satisfied, generally accepted accounting principles are an important factor, but are not dispositive.

(ii) In the case of a liability described in paragraph (g)(3) (rebates and refunds), paragraph (g)(4) (awards, prizes, and jackpots), paragraph (g)(5) (insurance, warranty, and service contracts), paragraph (g)(6) (taxes), or paragraph (h) (continuing fees under the Nuclear Waste Policy Act of 1982) of § 1.461-4, the matching requirement of paragraph (b)(1)(iv)(B) of this section shall be deemed satisfied.

(c) *Types of liabilities not eligible for treatment under the recurring item exception.* The recurring item exception does not apply to any liability of a taxpayer described in paragraph (e) (interest), paragraph (g)(2) (workers compensation, tort, breach of contract, and violation of law), or paragraph (g)(7) (other liabilities) of § 1.461-4. Moreover, the recurring item exception does not apply to any liability incurred by a tax shelter, as defined in section 461(i) and § 1.448-1T(b).

(d) *Time and manner of adopting the recurring item exception—(1) In general.* The recurring item exception is a method of accounting that must be consistently applied with respect to a type of item, or for all items, from one taxable year to the next in order to clearly reflect income. A taxpayer is permitted to adopt the recurring item exception as part of its method of accounting for any type of item for the first taxable year in which that type of item is incurred. Except as otherwise provided, the rules of section 446(e) and § 1.446-1(e) apply to changes to or from the recurring item exception as a method of accounting. For taxable years ending before April 7, 1995, see Q&A-7 of § 1.461-7T (as it appears in 26 CFR part 1 revised April 1, 1995) for rules concerning the time and manner of adopting the recurring item exception for taxable years that include July 19, 1984. For purposes of this section, items are to be classified by type in a manner that results in classifications that are no less inclusive than the classifications of production costs provided in the full-absorption regulations of § 1.471-11(b) and (c), whether or not the

taxpayer is required to maintain inventories.

(2) *Change to the recurring item exception method for the first taxable year beginning after December 31, 1991*—(i) *In general.* For the first taxable year beginning after December 31, 1991, a taxpayer is granted the consent of the Commissioner to change to the recurring item exception method of accounting. A taxpayer is also granted the consent of the Commissioner to expand or modify its use of the recurring item exception method for the first taxable year beginning after December 31, 1991. For each trade or business for which a taxpayer elects to use the recurring item exception method, the taxpayer must use the same method of change (cut-off or full-year change) it is using for that trade or business under § 1.461-4(m). For taxable year ending before April 7, 1995, see Q&A-11 of § 1.461-7T (as it appears in 26 CFR part 1 revised April 1, 1995) for an explanation of how amounts are taken into account under the cut-off method (except that, for purposes of this paragraph (d)(2), the change applies to all amounts otherwise incurred on or after the first day of the first taxable year beginning after December 31, 1991). For taxable years ending before April 7, 1995, see Q&A-6 of § 1.461-7T (as it appears in 26 CFR part 1 revised April 1, 1995) for an explanation of how amounts are taken into account under the full-year change method (except that the change in method occurs on the first day of the first taxable year beginning after December 31, 1991). For taxable years ending before April 7, 1995, the full-year change in method may result in a section 481(a) adjustment that must be taken into account in the manner described in Q&A-8 and Q&A-9 of § 1.461-7T (as it appears in 26 CFR part 1 revised April 1, 1995) (except that the taxable year of change is the first taxable year beginning after December 31, 1991).

(ii) *Manner of changing to the recurring item exception method.* For the first taxable year beginning after December 31, 1991, a taxpayer may change to the recurring item exception method by accounting for the item on its timely filed original return for such taxable year (including extensions). For tax-

able years ending before April 7, 1995, the automatic consent of the Commissioner is limited to those items accounted for under the recurring item exception method on the timely filed return, unless the taxpayer indicates a wider scope of change by filing the statement provided in Q&A-7(b)(2) of § 1.461-7T (as it appears in 26 CFR part 1 revised April 1, 1995).

(3) *Retroactive change to the recurring item exception method.* For the first taxable year beginning after December 31, 1989, or December 31, 1990, a taxpayer is granted consent of the Commissioner to change to the recurring item exception method of accounting, provided the taxpayer complies with paragraph (d)(2) of this section on either the original return for such year or on an amended return for such year filed on or before October 7, 1991. For this purpose the effective date is the first day of the first taxable year beginning after December 31, 1989, or the first day of the first taxable year beginning after December 31, 1990. A taxpayer is also granted the consent of the Commissioner to expand or modify its use of the recurring item exception method for the first taxable year beginning after December 31, 1989, December 31, 1990, or December 31, 1991.

(e) *Examples.* The following examples illustrate the principles of this section:

Example 1. Requirements for use of the recurring item exception. (i) Y corporation, a calendar year, accrual method taxpayer, manufactures and distributes video cassette recorders. Y timely files its federal income tax return for each taxable year on the extended due date for the return (September 15, of the following taxable year). Y offers to refund the price of a recorder to any purchaser not satisfied with the recorder. During 1992, 100 purchasers request a refund of the \$500 purchase price. Y refunds \$30,000 on or before September 15, 1993, and the remaining \$20,000 after such date but before the end of 1993.

(ii) Under paragraph (g)(3) of § 1.461-4, economic performance with respect to \$30,000 of the refund liability occurs on September 15, 1993. Assume the refund is deductible (or allowable as an adjustment to gross receipts or cost of goods sold) when incurred. If Y does not adopt the recurring item exception with respect to rebates and refunds, the \$30,000 refund is incurred by Y for the 1993 taxable year. However, if Y has properly adopted the recurring item exception method of accounting under this section, and as of December

31, 1992, all events have occurred that determine the fact of the liability for the \$30,000 refund, Y incurs that amount for the 1992 taxable year. Because economic performance (payment) with respect to the remaining \$20,000 occurs after September 15, 1993 (more than 8½ months after the end of 1992), that amount is not eligible for recurring item treatment under this section. Thus, the \$20,000 amount is not incurred by Y until the 1993 taxable year.

Example 2. Requirements for use of the recurring item exception; amended returns. The facts are the same as in *Example 2*, except that Y files its income tax return for 1992 on March 15, 1993, and Y does not refund the price of any recorder before that date. Under paragraph (b)(1) of this section, the refund liability is not eligible for the recurring item exception because economic performance with respect to the refund does not occur before Y files a return for the taxable year for which the item would have been incurred under the exception. However, since economic performance occurs within 8½ months after 1992, Y may file an amended return claiming the \$30,000 as incurred for its 1992 taxable year (see paragraph (b)(2) of this section).

[T.D. 8408, 57 FR 12427, Apr. 10, 1992, as amended by T.D. 8593, 60 FR 18743, Apr. 13, 1995]

§ 1.461-6 Economic performance when certain liabilities are assigned or are extinguished by the establishment of a fund.

(a) *Qualified assignments of certain personal injury liabilities under section 130.* In the case of a qualified assignment (within the meaning of section 130(c)), economic performance occurs as a taxpayer-assignor makes payments that are excludible from the income of the assignee under section 130(a).

(b) *Section 468B.* Economic performance occurs as a taxpayer makes qualified payments to a designated settlement fund under section 468B, relating to special rules for designated settlement funds.

(c) *Payments to other funds or persons that constitute economic performance.* [Reserved]

(d) *Effective dates.* The rules in paragraph (a) of this section apply to payments after July 18, 1984.

[T.D. 8408, 57 FR 12428, Apr. 10, 1992]

§ 1.465-1T Aggregation of certain activities (temporary).

(a) *General rule.* A partner in a partnership or an S corporation share-

holder may aggregate and treat as a single activity—

(1) The holding, production, or distribution of more than one motion picture film or video tape by the partnership or S corporation,

(2) The farming (as defined in section 464 (e)) of more than one farm by the partnership or S corporation,

(3) The exploration for, or exploitation of, oil and gas resources with respect to more than one oil and gas property by the partnership or S corporation, or

(4) The exploration for, or exploitation of, geothermal deposits (within the meaning of section 613(e)(3)) with respect to more than one geothermal property by the partnership or S corporation.

Thus, for example, if a partnership or S corporation is engaged in the activity of exploring for, or exploiting, oil and gas resources with respect to 10 oil and gas properties, a partner or S corporation shareholder may aggregate those properties and treat the aggregated oil and gas activities as a single activity. If that partnership or S corporation also is engaged in the activity of farming with respect to two farms, the partner or shareholder may aggregate the farms and treat the aggregated farming activities as a single separate activity. Except as provided in section 465(c)(2)(B)(ii), the partner or shareholder cannot aggregate the farming activity with the oil and gas activity.

(b) *Effective date.* This section shall apply to taxable years beginning after December 31, 1983 and before January 1, 1985.

(Secs. 465(c)(2)(B) and 7805 of the Internal Revenue Code of 1954 (98 Stat. 814, 68A Stat. 917; 26 U.S.C. 465(c)(2)(B) and 7805))

[T.D. 8012, 50 FR 9614, Mar. 11, 1985]

§ 1.465-8 General rules; interest other than that of a creditor.

(a) *In general—(1) Amounts borrowed.* This section applies to amounts borrowed for use in an activity described in section 465(c)(1) or (c)(3)(A). Amounts borrowed with respect to an activity will not increase the borrower's amount at risk in the activity if the lender has an interest in the activity other than that of a creditor or