Capitol Fed. Sav. & Loan Ass'n v. Commissioner, 96 T. C. 204 (1991)

The IRS's discretion to refuse processing an accounting method change request under examination is reviewable for abuse, but not if refusal aligns with IRS policy to protect tax administration.

Summary

Capitol Federal Savings & Loan Association sought to change its accounting method for interest income from mortgage passthrough certificates during an IRS examination. The IRS, citing Revenue Procedure 80-51, declined to process the change request, instead implementing the change in the earliest open year. The court upheld the IRS's discretion, finding no abuse in refusing to process the request during an examination, even if the method was not specifically prohibited. The ruling emphasizes the IRS's broad discretion in managing accounting method changes during audits and the limited judicial review for abuse of that discretion.

Facts

Capitol Federal Savings & Loan Association used the cash method of accounting for interest income from mortgage passthrough certificates. In 1984, its accounting firm advised a change to align with IRS Revenue Rulings. In January 1985, before filing the change request, Capitol Federal was contacted by the IRS for examination. The association filed its change request in February 1985, seeking to implement the change in 1985 and spread the adjustment over seven years. The IRS, finding Capitol Federal under examination, refused to consider the request and implemented the change in the earliest open year, 1982.

Procedural History

Capitol Federal filed a petition with the U. S. Tax Court challenging the IRS's refusal to process its accounting method change request and the related adjustments. The IRS had determined deficiencies for the years 1978 and 1984 due to the accounting method change implemented in 1982. The Tax Court reviewed the IRS's actions under its discretion to change accounting methods and its refusal to process the change request.

Issue(s)

1. Whether the IRS properly exercised its discretion under IRC § 446(b) in changing the petitioner's method of accounting?
2. Whether the IRS's refusal to consider the petitioner's application for an accounting method change is reviewable for abuse of discretion?
3. Whether the IRS's refusal to permit the adjustment required under IRC § 481(a) to be taken into account over more than one taxable year is reviewable for abuse of discretion?
4. Whether the IRS abused its discretion by refusing to consider the petitioner's

application?

Holding

1. Yes, because the petitioner conceded that its old method did not clearly reflect income, and the IRS's method was proper under IRC § 446(b).
2. Yes, because the IRS's refusal to process the application is an administrative decision subject to judicial review for abuse of discretion.
3. Yes, because the IRS's refusal to spread the adjustment over multiple years is reviewable under IRC § 481(c) and its regulations.
4. No, because the IRS reasonably concluded that the petitioner was under examination and its refusal was in line with IRS policy to protect tax administration.

Court's Reasoning

The court found that the IRS's discretion under IRC § 446(b) to change accounting methods was properly exercised, as the petitioner conceded its method did not clearly reflect income. Regarding the refusal to process the change request, the court held that such a refusal is reviewable for abuse of discretion, especially when the IRS invites reliance on its procedures. However, the court concluded that the IRS did not abuse its discretion in refusing to process the request. It reasoned that the IRS's policy under Revenue Procedure 80-51 to prevent taxpayers under examination from changing accounting methods was sound and aimed at preventing abuse of the examination process. The court also noted that the IRS's refusal to spread the adjustment over multiple years was within its discretion under IRC § 481(c) and its regulations, which require an agreement between the IRS and the taxpayer.

Practical Implications

This decision reinforces the IRS's broad discretion to manage accounting method changes during audits, highlighting the importance of timing in filing such requests. Taxpayers should be aware that attempts to change accounting methods during an examination may be refused by the IRS, and such refusals are subject to limited judicial review for abuse of discretion. The ruling suggests that practitioners should carefully consider when to file such requests, ideally before an examination begins, to avoid potential refusals. Later cases may reference this decision when addressing the IRS's discretion in similar situations, particularly in the context of Revenue Procedure 80-51 and its successors.

