

Part III

Administrative, Procedural, and Miscellaneous

26 CFR 601.204: Changes in accounting periods and methods of accounting.
(Also Part I, ' ' 61, 451, 471, 481; 1.451-1.)

Rev. Proc. 2007-53

SECTION 1. PURPOSE

In general, the Internal Revenue Service will follow *Westpac Pacific Food v. Commissioner*, 451 F.3d 970 (9th Cir. 2006), with respect to taxpayers that adopt the Advance Trade Discount Method of accounting described in section 4 of this revenue procedure. Accordingly, this revenue procedure permits accrual method taxpayers described in section 3 of this revenue procedure to account for advance trade discounts under the Advance Trade Discount Method. This revenue procedure also provides procedures to obtain the automatic consent of the Commissioner to change to the Advance Trade Discount Method.

SECTION 2. BACKGROUND

In *Westpac*, an accrual method taxpayer received payments, referred to as “advance trade discounts,” upon entering into contracts with sellers of merchandise. Under the contracts, the taxpayer was required to purchase a minimum amount of merchandise during the term of a contract and was obligated to refund a pro rata portion of the cash payment to the extent the purchase commitment was not satisfied. In *Westpac*, the court held that the advance trade discount was not recognized as gross income under § 61 by the taxpayer when received.

SECTION 3. SCOPE

This revenue procedure applies to an accrual method taxpayer required to use an inventory method of accounting and maintaining inventories, as provided for in § 471 of the Internal Revenue Code and the regulations thereunder, that receives advance trade discounts (as defined in section 4.03 of this revenue procedure).

SECTION 4. ADVANCE TRADE DISCOUNT METHOD

.01 *In General.* A taxpayer within the scope of this revenue procedure is permitted to use the Advance Trade Discount Method of accounting. Under the Advance Trade Discount Method, an advance trade discount (as defined in section 4.03 of this revenue procedure) is not recognized as gross income under § 61 upon receipt. The advance trade discount generally is taken into account for federal income tax purposes in the amount of, in the manner of, and for the taxable year in which the taxpayer accounts for the discount in its applicable financial statements (as defined in section 4.06 of this revenue procedure). Thus, if a taxpayer reports an advance trade discount related to specific items of inventory in its applicable financial statements as a reduction to the cost of that inventory, the taxpayer must treat the discount as a trade or other discount under § 471 and reduce only the cost of the inventory to which the discount relates in the amount of, in the same manner as, and for the taxable year in which it reduces the cost of that inventory in its applicable financial statements. The taxpayer may not, for example, unwind the allocation made in its applicable financial statements and instead allocate the discount using the simplified resale method. Alternatively, if a taxpayer allocates an advance trade discount in its applicable financial

statements exclusively to cost of goods sold, the taxpayer must treat the discount as a reduction to the cost of goods sold in the amount of and for the taxable year in which the discount is allocated to cost of goods sold in its applicable financial statements. However, a taxpayer must reduce the cost of the inventory to which the discount relates as the taxpayer purchases the inventory if that treatment results in the advance trade discount being recognized for federal income tax purposes earlier than when the taxpayer accounts for the discount in its applicable financial statements.

.02 Taxpayers Without Applicable Financial Statements. To use the Advance Trade Discount Method, a taxpayer within the scope of this revenue procedure that does not have applicable financial statements (as defined in section 4.06 of this revenue procedure) must reduce only the cost of the specific items of inventory to which the discount relates as the taxpayer purchases the inventory.

.03 Advance Trade Discounts. A payment received by a taxpayer is an advance trade discount if:

- (1) The payment is received from a seller of merchandise in exchange for a commitment by the taxpayer to purchase a minimum amount of merchandise from the seller within a period that does not exceed 5 years from the date of the agreement;
- (2) Except as provided for in section 4.04 of this revenue procedure, the payment is intended to be a discount to the price of the merchandise to be purchased;
- (3) The taxpayer is obligated, either in writing or because of industry custom, to repay an allocable portion, or all, of the payment if the underlying purchase commitment is not met; and

(4) The taxpayer does not treat the payment as a payment for services in its applicable financial statements (as defined in section 4.06 of this revenue procedure), if any.

.04 Exclusive Supplier Agreements and Shelving Allowances. Solely for purposes of the Advance Trade Discount Method, amounts allocable to exclusive supplier agreements and shelving (slotting) allowances included as part of a purchase commitment described in section 4.03(1) of this revenue procedure will be treated as advance trade discounts if the taxpayer is obligated to repay an allocable portion of those amounts if the underlying purchase commitment is not met and the requirements in sections 4.03(3) and (4) of this revenue procedure are satisfied.

.05 Allocable Payments. Except as provided for in section 4.04 of this revenue procedure, a taxpayer that receives a payment that is partially attributable to an advance trade discount described in section 4.03 of this revenue procedure may use the Advance Trade Discount Method only with respect to the portion of the payment that is allocable to the advance trade discount based on objective criteria. For example, if the taxpayer receives a payment, part of which is for an advance trade discount and for part of which the taxpayer is obligated to perform or provide cooperative advertising services, the taxpayer may use the Advance Trade Discount Method only for the portion of the payment that the taxpayer is able to demonstrate, based on objective criteria, is attributable to the advance trade discount.

.06 Applicable Financial Statement. The taxpayer's applicable financial statement is the taxpayer's financial statement listed in paragraphs (1) through (3) of

this section 4.06 that has the highest priority (including within paragraph (2)). A taxpayer that does not have a financial statement described in paragraphs (1) through (3) of this section 4.06 does not have an applicable financial statement for purposes of this revenue procedure. The financial statements are, in descending priority --

(1) a financial statement required to be filed with the Securities and Exchange Commission ("SEC") (the 10-K or the Annual Statement to Shareholders);

(2) a certified audited financial statement that is accompanied by the report of an independent CPA (or in the case of a foreign corporation, by the report of a similarly qualified independent professional), that is used for --

(a) credit purposes,

(b) reporting to shareholders, or

(c) any other substantial non-tax purpose; or

(3) a financial statement (other than a tax return) required to be provided to the federal or a state government or any federal or state agency (other than the SEC or the Internal Revenue Service).

SECTION 5. AUDIT PROTECTION FOR TAXPAYERS CURRENTLY USING THE ADVANCE TRADE DISCOUNT METHOD

A taxpayer's use of the Advance Trade Discount Method provided for in section 4 of this revenue procedure on a federal income tax return filed before July 2, 2007, will not be raised as an issue by the Service. Moreover, if a taxpayer's use of the Advance Trade Discount Method on a federal income tax return filed before July 2, 2007, is an issue under consideration in examination, appeals, or before the Tax Court, the issue will not be further pursued by the Service.

SECTION 6. CHANGE IN ACCOUNTING METHOD

.01 *In General.* A change in a taxpayer's method of accounting for advance trade discounts to the Advance Trade Discount Method provided for in section 4 of this revenue procedure is a change in method of accounting to which the provisions of §§ 446 and 481 and the regulations thereunder apply. Therefore, a taxpayer within the scope of this revenue procedure that wants to change to the Advance Trade Discount Method for taxable years ending on or after July 2, 2007, must obtain the consent of the Commissioner under § 446(e) and § 1.446-1(e)(3).

.02 *Automatic Change.* A taxpayer within the scope of this revenue procedure that wants to change to the Advance Trade Discount Method must obtain the consent of the Commissioner by following the automatic change in method of accounting procedures in Rev. Proc. 2002-9, 2002-1 C.B. 327 (as modified and clarified by Announcement 2002-17, 2002-1 C.B. 561, modified and amplified by Rev. Proc. 2002-19, 2002-1 C.B. 696, and amplified, clarified, and modified by Rev. Proc. 2002-54, 2002-2 C.B. 432) (or its successor), with the following additional modifications: (1) the scope limitations in section 4.02 of Rev. Proc. 2002-9 do not apply to a taxpayer that wants to make the change for its first taxable year ending on or after July 2, 2007; and (2) for purposes of section 6.02(4)(a) of Rev. Proc. 2002-9, the taxpayer must include on Line 1a of the Form 3115 the designated automatic accounting method change number "111."

SECTION 7. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 2002-9 is modified and amplified to include in the APPENDIX the

automatic change provided in this revenue procedure.

DRAFTING INFORMATION

The principal author of this revenue procedure is Norma Rotunno of the Office of Associate Chief Counsel (Income Tax & Accounting). For further information regarding this notice, contact Grant D. Anderson at (202) 622-4930 (not a toll-free number).