



September 12, 2024

By electronic mail

Andres Garcia  
Internal Revenue Service, Room 6526  
1111 Constitution Avenue NW  
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pra.comments@irs.gov

Re: Comments on Form 3115, Application for Change in Accounting Method;  
OMB Control No. 1545-0123

Dear Mr. Garcia:

Thank you for the opportunity to provide comments on continuing information collections with respect to forms used by business entity taxpayers, pursuant to the recent notice and request for comments (89 F.R. 73752-73761 (September 11, 2024)). Our comments pertain to Form 3115, Application for Change in Accounting Method. We write presently to offer our perspectives on ways to enhance the quality, utility, and clarity of the information to be collected on Form 3115. Specifically, our perspectives pertain to an ambiguity concerning Forms 3115 filed by partnerships and by partners.

Clarification is needed in the Form 3115 instructions to identify the proper taxpayer that should request a change in method of accounting, for situations when the accounting method involves depreciation, depletion, amortization, and/or gain or loss with respect to section 743(b) adjustments to the adjusted tax basis of partnership property by a partnership that has a section 754 election in effect.

**Background**

Treas. Reg. section 1.446-1(e)(2)(ii)(a) provides that 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. A "material item" includes "any item that involves the proper time for the inclusion of the item in income or the taking of a deduction." *Id.* If a change leaves a taxpayer's lifetime taxable income constant but affects when it is recognized, the change concerns an "item that involves the proper time for the inclusion of [an] item in income or the taking of a deduction" and implicates a change in method of accounting. *Id.*

The Court has applied these concepts in the context of section 481 adjustments by focusing on whether a taxpayer's accounting practice permanently distorts the taxpayer's lifetime income. Where a taxpayer's

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accounting practice permanently avoids reporting of income and accordingly distorts its lifetime income, the practice is not a method of accounting and section 481(a) is inapplicable to a change of the accounting practice. *Schuster's Express, Inc. v. Commissioner*, 66 T.C. 588 (1976), *aff'd without published opinion*, 562 F.2d 39 (2d Cir. 1977). On the other hand, when an accounting practice merely postpones the reporting of income, rather than permanently avoiding the reporting of income over the taxpayer's lifetime, it involves the proper time for reporting income. Rev. Proc. 2002-18, 2002-1 C.B. 678, section 2.01(1), Rev. Proc. 91-31, 1991-1 C.B. 566, section 3.02; *Wayne Bolt & Nut Co. v. Commissioner*, 93 T.C. 500, 510 (1989); *Copy Data, Inc. v. Commissioner*, 91 T.C. 26, 30 (1988); *Primo Pants Co. Commissioner*, 78 T.C. 705, 723 (1982); *Schuster's Express, Inc.*, 66 T.C. 588, 597 (1976).

Section 743(b) provides that in the case of a transfer of an interest in a partnership by sale or exchange, a partnership with a section 754 election in effect (1) shall increase the adjusted basis of the partnership property by the excess of the basis to the transferee partner of the transferred interest in the partnership over the transferee partner's proportionate share of the adjusted basis of partnership property, or (2) shall decrease the adjusted basis of partnership property by the excess of the transferee partner's proportionate share of the adjusted basis of the partnership property over the basis of the transferee partner's partnership interest.

Treas. Reg. section 1.704-1(b)(2)(iv)(m)(2) provides, in relevant part, that in the case of a transfer of all or a part of an interest in a partnership that has a section 754 election in effect for the partnership taxable year in which the transfer occurs, adjustments to the adjusted tax basis of partnership property under section 743 shall not be reflected in the capital account of the transferee partner *or on the books of the partnership*, and subsequent capital account adjustments for distributions and for depreciation, depletion, amortization, and gain or loss with respect to such property will disregard the effect of such basis adjustment.

Treas. Reg. section 1.743-1(j)(1) provides that the basis adjustment constitutes an adjustment to the basis of partnership property with respect to the transferee only. *No adjustment is made to the common basis of partnership property. See, e.g.,* PLR 202215001; PLR 202135007; 201934002; 8931006. Thus, for purposes of calculating income, deduction, gain, and loss, the transferee will have a special basis for those partnership properties the bases of which are adjusted under section 743(b) and the regulations. The adjustment to the basis of partnership property under section 743(b) has no effect on the partnership's computation of any item under section 703. CCA 201726012.

For purposes of section 446 within a partnership setting, lifetime taxable income is analyzed with respect to the item(s) at issue solely at the partnership level. *See, e.g.,* Treas. Reg. section 1.481-2(c)(5)(i); CCA 201521012. An election under section 754 does not affect the total income recognized by all the partners over the life of the partnership (*i.e.*, section 754 adjustments pertain to a method of accounting because they do not affect the lifetime taxable income recognized by the partners). CCA 201521012.



## Analysis

A method of accounting that involves depreciation, depletion, amortization, and/or gain or loss with respect to section 743(b) adjustments to the adjusted tax basis of partnership property does not impact the common basis of partnership property, and it has no effect on the partnership's computation of any item under section 703. Because the transferee partner alone will have the special basis adjustment for those partnership properties that are adjusted under section 743(b), the method of accounting involving depreciation, depletion, amortization, and/or gain or loss for the section 743(b) adjustment likewise is associated with the transferee partner alone. While the partnership must calculate and disclose certain information on Schedule K-1 pertaining to depreciation, depletion, amortization, and/or gain or loss with respect to section 743(b) adjustments, the special basis adjustments under section 743(b) nevertheless belong to the transferee alone.

When an occasion arises (such as a situation involving a cost segregation study on partnership property) that involves an impermissible method of determining depreciation, depletion, amortization, and/or gain or loss for section 743(b) adjustments, an impermissible method of accounting is implicated because section 754 adjustments do not affect the lifetime taxable income recognized by partners in a partnership.

The partnership determines whether it experiences a change in method of accounting solely with respect to items at the partnership level. In this situation, there arguably are no items at the partnership level. This leads to an implication that only the transferee has the capacity to request a change in method of accounting with respect to such items, because the section 743(b) basis adjustment constitutes an adjustment to the basis of partnership property with respect to the transferee alone.

On the other hand, the partnership must calculate and disclose certain information on Schedule K-1 pertaining to section 743(b) adjustments, as previously noted. For purposes of the centralized partnership audit regime, this calculation and disclosure requirement plainly causes information pertaining to section 743(b) adjustments to be a "partnership-related item," because the item is relevant in determining the chapter 1 tax liability of a person, and "is shown or reflected, or required to be shown or reflected, on a return of the partnership under section 6031 or the forms and instructions prescribed by the Internal Revenue Service ... or is required to be maintained in the partnership's books or records." Section 6241(2)(B); Treas. Reg. sections 301.6241-1(a)(6)(ii), (iii). As a matter of practical necessity, this partnership-level calculation and disclosure requirement obligates the partnership to determine the proper method of accounting for information pertaining to section 743(b) adjustments. This makes it more appropriate and practical for the partnership to request any associated changes in methods of accounting.

Furthermore, there are circumstances when the partnership acts in some respect as an agent for the partner when selecting the form of cost recovery with respect to section 743(b) adjustments. For example, an election under section 168(k)(7) not to deduct additional first year depreciation for an increase in the basis of qualified property under section 743(b) is made by the partnership, not the partner. Treas. Reg. section 1.743-

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1(j)(4)(i)(B)(1); Treas. Reg. section 1.168(k)-2(f)(1)(iii)(B). From an administrative perspective, the transferee partner does not make such an election, despite the fact that the transferee partner alone “owns” the special basis adjustment under section 743(b). By analogy, it could also be reasoned that it is the partnership in its capacity as an agent, and not the partner, that must request a change in method of accounting for information pertaining to section 743(b) adjustments.

## **Conclusion**

The better argument appears to be that the partnership, and not the partner, should request a change in method of accounting that involves depreciation, depletion, amortization, and/or gain or loss with respect to section 743(b) basis adjustments. This is because the partnership is required to properly calculate and disclose information pertaining to section 743(b) adjustments, and often functions as an agent for the partner with respect to section 743(b) adjustments. This makes it more appropriate and practical for the partnership to request any associated changes in method of accounting. But a persuasive argument could also be made in support of the partner’s obligation to request the change, which leads to ambiguity in this regard. Therefore, the Form 3115 instructions should be clarified to specify the appropriate party that should request a change in method of accounting with respect to section 743(b) basis adjustments.

We thank you in advance for your time and consideration in this matter and welcome any feedback or questions that you may have.

Best regards,

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