

Permission to Change to the Cash Method of Accounting

Notice 2002-14

Notice 2001-76 (2001-52 I.R.B. 613) sets forth a proposed revenue procedure that would permit certain small businesses with average annual gross receipts of \$10 million or less to use the cash receipts and disbursements method of accounting (“cash method”) and to treat inventoriable items as non-incident materials and supplies (“materials and supplies method”) with respect to eligible trades or businesses. Pursuant to the Commissioner’s discretion under § 446(e) of the Internal Revenue Code, this notice provides that any qualifying small business taxpayer within the scope of the proposed revenue procedure (“small business taxpayer”) may change to these methods of accounting with respect to its eligible trades or businesses for any taxable year ending on or after December 31, 2001.

Pending publication of a final revenue procedure in the Internal Revenue Bulletin, a small business taxpayer may obtain automatic consent to change to the cash method and the materials and supplies method by complying with the procedures provided in the proposed revenue procedure. These procedures state that a small business taxpayer may change to the cash method and the materials and supplies method for any taxable year ending on or after December 31, 2001, by attaching the original Form 3115, *Application for Change in Accounting Method*, to its timely filed (including extensions) federal income tax return for that year (or on an amended return filed within six months of the original due date of the return), filing a duplicate of the Form 3115 with the Internal Revenue Service’s National Office, and complying with the provisions of Rev. Proc. 2002-9 (2002-3 I.R.B. 327) as modified by the proposed revenue procedure. Both changes may be made on a single Form 3115. A taxpayer that has fully complied with these procedures has obtained the consent of the Commissioner under § 446(e) to change its method of accounting to these methods.

DRAFTING INFORMATION

The principal author of this notice is Cheryl L. Oseekey of the Office of Associate Chief Counsel (Income Tax and Accounting). For further information regarding this notice, contact Ms. Oseekey at (202) 622-4970 (not a toll-free call).

Additional Disaster Relief for Taxpayers Affected by the September 11, 2001, Terrorist Attack

Notice 2002-15

PURPOSE

This notice supplements the tax relief granted in Notice 2001-61 (2001-40 I.R.B. 305) (October 1, 2001), and Notice 2001-68 (2001-47 I.R.B. 504) (November 19, 2001), for taxpayers affected by the September 11, 2001, Terrorist Attack by providing an additional postponement of time for certain affected taxpayers to apply for a tentative carryback adjustment under I.R.C. § 6411. The relief provided to taxpayers in this notice will apply retroactively to September 11, 2001.

GRANT OF RELIEF

Paragraph (3) of the Additional Grant of Relief section (Section C) of Notice 2001-68, granted to all affected taxpayers a 120-day postponement of time to perform the acts listed in Rev. Proc. 2001-53 (2001-47 I.R.B. 506) (November 19, 2001), if the last day to perform the act would otherwise fall within the period beginning on September 11, 2001, and ending on November 30, 2001 (the “window period”). One of the acts listed in Rev. Proc. 2001-53 is the application under section 6411 for a tentative carryback adjustment of the tax for a prior taxable year. To apply for a tentative carryback adjustment, corporate taxpayers must file Form 1139 and noncorporate taxpayers must file Form 1045 on or after the due date of the return for the taxable year that generates the net operating loss, net capital loss, or unused business credit from which the carryback results and within 12 months after the end of such

year. This procedure allows a taxpayer to obtain a refund without having to file an amended return for the year to which the taxpayer carries back the loss or credit. Normally, the twelve month period for filing for the tentative carryback falls after the filing due date even if the filing due date is extended for six months under section 6081. Taxpayers affected by the September 11, 2001, Terrorist Attack that received a filing extension and/or postponement under Notice 2001-61, however, now have a due date for the return that falls after the 12 month period provided by section 6411. In cases where the due date for filing for the tentative carryback under section 6411 falls outside the window period provided by section C, paragraph (3) of Notice 2001-68, such taxpayers would have to file for their tentative carryback before they filed the return for the year the loss or credit arose. To remedy this situation, this notice expands the relief provided by section C, paragraph (3) of Notice 2001-68 by providing affected taxpayers with an additional 120 days in which to file for their tentative carryback under section 6411 if Notice 2001-61 extended and/or postponed the due date of their income tax return.

For example, an affected individual income taxpayer who obtained an extension of time to file the 2000 tax return until October 15, 2001, would qualify for a 120-day postponement of time to file under Notice 2001-61 until February 12, 2002. Under section 6411, the last day the taxpayer could file Form 1045 would be December 31, 2001. This date is not within the period provided by Notice 2001-61. Thus, without this notice, the taxpayer would need to file Form 1045 before the return is due. Under this notice, however, the taxpayer will have an additional 120 days from December 31, 2001 (the last day for applying for the tentative carryback under section 6411), to file Form 1045.

Taxpayers who believe they are entitled to relief under this notice should mark “September 11, 2001 Terrorist Attack” in red ink on the top of their Form 1139 or 1045 submitted to the IRS. ***Taxpayers should not put this notation on envelopes.*** Doing so may result in a delay in the delivery or processing of the return or document.

DRAFTING INFORMATION

This notice was drafted by the Office of Associate Chief Counsel, Procedure and Administration (Administrative Provisions and Judicial Practice Division). For further information regarding this notice, you may call (202) 622-4940 (not a toll-free call).

*26 CFR 601.105: Examination of returns and claims for refund, credit, or abatement; determination of correct tax liability.
(Also, Part 1, 280G.)*

Rev. Proc. 2002-13

SECTION 1. PURPOSE

This revenue procedure provides guidance for valuing stock options, including a safe harbor for valuing compensatory stock options for purposes of §§ 280G and 4999 of the Internal Revenue Code. The Internal Revenue Service will treat the value of a compensatory stock option determined in accordance with the requirements of this revenue procedure as properly determined for purposes of §§ 280G and 4999.

SECTION 2. BACKGROUND

Section 280G denies a deduction to a corporation for any excess parachute payment. An excess parachute payment is defined in § 280G(b)(1) as an amount equal to the excess of any parachute payment over the portion of the disqualified individual's base amount that is allocated to such payment.

Section 280G(b)(2)(A) defines a parachute payment as any payment in the nature of compensation to (or for the benefit of) a disqualified individual if such payment is (i) contingent on a change in the ownership of a corporation, the effective control of a corporation, or the ownership of a substantial portion of the assets of a corporation (a change in ownership or control), and (ii) the aggregate present value of the payments in the nature of compensation which are contingent on such change equals or exceeds an amount equal to 3 times the base amount. The term parachute payment also includes any payment in the nature of compensation to, or for the benefit of, a

disqualified individual if the payment is pursuant to an agreement that violates any generally enforced securities laws or regulations.

A payment in the nature of compensation for purposes of § 280G includes the transfer of an option (including an option to which § 421 applies), without regard to whether the option has a readily ascertainable fair market value within the meaning of § 83. The option is considered transferred not later than the time at which the option becomes substantially vested (within the meaning of § 1.83-3(b) and (j)).

An individual's base amount is, in general, the individual's average annualized includible compensation for the most recent 5 taxable years ending before the date of the corporation's change in ownership or control. For this purpose, the portion of the base amount allocated to a parachute payment is the amount that bears the same ratio to the base amount as the present value of the parachute payment bears to the aggregate present value of all such payments to the same disqualified individual.

Section 4999 imposes a 20-percent excise tax on the recipient of any excess parachute payment, within the meaning of § 280G(b).

Rev. Proc. 98-34 (1998-1 C.B. 983) provides a methodology for valuation of certain compensatory stock options for purposes of gift, estate, and generation-skipping transfer taxes. The methodology described in Rev. Proc. 98-34 is an option pricing model that takes into account factors similar to those established by the Financial Accounting Standards Board in Accounting for Stock-Based Compensation, Statement of Financial Accounting Standards No. 123 (Fin. Accounting Standards Bd. 1995 (FAS 123)). This methodology applies only to the valuation of a nonpublicly traded compensatory stock option for stock that, on the valuation date, is publicly traded on an established securities market.

SECTION 3. STOCK OPTION VALUATION

.01 In general, a taxpayer may value a compensatory stock option using any valuation method that is consistent with generally accepted accounting principles

(such as FAS 123) and that takes into account the factors provided in § 1.280G-1, Q&A 13. A valuation using the valuation safe harbor method provided in Section 4 is considered consistent with generally accepted accounting principles for purposes of §§ 280G and 4999 and this revenue procedure.

.02 If the stock option is one that could otherwise be valued under Rev. Proc. 98-34 because the stock option is one that satisfies the definition of "Compensatory Stock Option" under section 3 of Rev. Proc. 98-34, then, for purposes of §§ 280G and 4999 and this revenue procedure, the valuation is not considered consistent with generally accepted accounting principles unless the valuation is made in accordance with Rev. Proc. 98-34 or the valuation safe harbor method provided in section 4 of this revenue procedure.

SECTION 4. VALUATION SAFE HARBOR

.01 *In general.* The safe harbor valuation method provided by this revenue procedure is based on the Black-Scholes model and takes into account, as of the valuation date, the following factors: (1) the volatility of the underlying stock, (2) the exercise price of the option, (3) the value of the stock at the time of the valuation (the "spot price"), and (4) the term of the option on the valuation date. The safe harbor value of the option is calculated as the number of options multiplied by the spot price of the stock multiplied by a valuation factor determined using the factors described above and reflected in the table in the Appendix. Other relevant factors, including risk-free rate of interest and assumptions related to dividend yields are included in the table in the Appendix. To determine the valuation factor, the taxpayer must determine the volatility, spread, and option term factors, as described below. To rely on this revenue procedure, assumptions made for purposes of this revenue procedure and the determination of each factor must be reasonable and consistent with assumptions made with respect to other options valued in connection with the change in ownership or control.

.02 *Volatility.* The taxpayer must determine whether the volatility of the underlying stock is low, medium, or high. For