

Part III

Administrative, Procedural, and Miscellaneous

26 CFR 601,204: Changes in accounting periods and in methods of accounting.
(Also: §§ 446, 1272)

Rev. Proc. 2004-33

SECTION 1. PURPOSE

This revenue procedure describes conditions under which the Commissioner will allow a taxpayer to treat its income from credit card late fees as interest income on a pool of credit card loans. This revenue procedure also provides the exclusive procedure by which a taxpayer within the scope of this revenue procedure may obtain the Commissioner's consent to change its method of accounting for income from credit card late fees to a method that treats these fees as interest that creates or increases the amount of original issue discount (OID) on the pool of credit card loans to which the fees relate.

SECTION 2. BACKGROUND

.01 Certain taxpayers issue credit cards that allow a cardholder to access a revolving line of credit to purchase goods and services. Some of these taxpayers may also issue credit cards that allow a cardholder to obtain cash advances.

.02 The terms and conditions that govern the cardholder's use of the credit card are provided in a credit card agreement. Under many credit card agreements, the cardholder is charged a fee when the cardholder is delinquent with respect to a payment due (late fee).

.03 For federal income tax purposes, interest is an amount that is paid in compensation for the use or forbearance of money. Deputy v. DuPont, 308 U.S. 488 (1940), 1940-1 C.B. 118; Old Colony Railroad Co. v. Commissioner, 284 U.S. 552 (1932), 1932-1 C.B. 274. Whether a fee is an interest charge for federal income tax purposes is determined by reference to all of the relevant facts and circumstances surrounding the imposition of the charge. Neither the label used for the charge (for example, a "finance charge") nor a taxpayer's treatment of the item for financial or regulatory reporting purposes is determinative of the proper federal income tax characterization of the fee. See Rev. Rul. 72-315, 1972-1 C.B. 49; see also Thor Power Tool Co. v. Commissioner, 439 U.S. 522, 542-43 (1979), 1979-1 C.B. 167.

.04 Rev. Rul. 74-187, 1974-1 C.B. 48, holds that late fees on utility bills are interest absent evidence that the late payment charge assessed by the public utility is for a specific service performed in connection with the customer's account. Even if a charge is a one-time charge or is imposed as a flat sum in addition to a stated periodic

interest rate, that charge may still be interest for federal income tax purposes. See Rev. Rul. 77-417, 1977-2 C.B. 60, and Rev. Rul. 72-2, 1972-1 C.B. 19.

.05 Under § 1273(a)(1) of the Internal Revenue Code, OID is the excess of the stated redemption price at maturity (SRPM) of a debt instrument over the issue price of that instrument. Under § 1273(a)(2), the SRPM of a debt instrument is the amount fixed by the last modification of the purchase agreement and includes interest and other amounts payable at that time, other than qualified stated interest (QSI). Under § 1.1273-1(b) of the Income Tax Regulations, the SRPM is the sum of all payments provided by the debt instrument other than QSI. Under § 1.1273-1(c), QSI is stated interest that is unconditionally payable in cash or property (other than debt instruments of the issuer) or that will be constructively received under § 451 at least annually at a single fixed rate.

.06 Section 1004 of the Taxpayer Relief Act of 1997, which is effective for taxable years beginning after August 5, 1997, extended the rules of § 1272(a)(6) to any pool of debt instruments the yield on which may be affected by reason of prepayments. See H.R. Conf. Rep. No. 220, 105th Cong., 1st Sess. 522 (1997). Section 1272(a)(6) provides rules for determining the daily portions of OID if principal is subject to acceleration.

.07 Any change in the taxpayer's treatment of income from credit card late fees that affects when those fees are recognized in income is a change in method of accounting to which the provisions of §§ 446 and 481 apply. Under § 1.446-1(e)(2)(i), a taxpayer generally must secure the consent of the Commissioner before changing a method of accounting for federal income tax purposes. Section 1.446-1(e)(3)(ii)

authorizes the Commissioner to prescribe administrative procedures setting forth the terms and conditions necessary to obtain consent to change a method of accounting.

.08 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), provides procedures by which taxpayers may obtain automatic consent to change to the methods of accounting described in the Appendix of Rev. Proc. 2002-9. Section 5.03 of Rev. Proc. 2002-9 provides that, unless otherwise provided, a taxpayer making a change in method of accounting under the revenue procedure must take into account a section 481(a) adjustment in the manner provided in section 5.04 of Rev. Proc. 2002-9.

SECTION 3. SCOPE

This revenue procedure applies to a taxpayer if—

.01 The taxpayer issues credit cards allowing cardholders to access a revolving line of credit established by the taxpayer; and

.02 None of the cardholders' credit card transactions with the taxpayer is treated by the taxpayer for federal income tax purposes as creating either debt that is given in consideration for the sale or exchange of property (within the meaning of §1274) or debt that is deferred payment for property (within the meaning of § 483).

SECTION 4. APPLICATION

.01 Subject to subsection .02 of this section 4, if a taxpayer is within the scope of this revenue procedure, the Commissioner will not challenge either the taxpayer's treatment of credit card late fees as interest or the taxpayer's treatment of this interest as

being part of SRPM and thus as creating or increasing OID on a pool of credit card loans to which these fees relate.

.02 Subsection .01 of section 4 of this revenue procedure applies only if the taxpayer follows all of the requirements of section 5 of this revenue procedure and, if the taxpayer is changing its method of accounting, all of the requirements of section 6 of this revenue procedure.

SECTION 5. REQUIREMENTS

A taxpayer must be able to demonstrate the following:

.01 The amount of any credit card late fee charged to each cardholder by the taxpayer is separately stated on the cardholder's account when the late fee is imposed; and

.02 Under the applicable credit card agreement governing each cardholder's use of the credit card, no amount identified as a credit card late fee is charged for property or for specific services performed by the taxpayer for the benefit of the cardholder.

SECTION 6. CHANGE IN METHOD OF ACCOUNTING

If a taxpayer within the scope of this revenue procedure wants to change its method of accounting for income from credit card late fees and if, under the method to which the taxpayer is changing, these fees are treated as interest that creates or increases the amount of OID on a pool of credit card loans to which these fees relate, the taxpayer must follow the provisions of Rev. Proc. 2002-9 (or its successor), with the following modifications:

.01 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 either its first or second taxable year ending on or after December 31, 2003; and

.02 The taxpayer must prepare and file a Form 3115 in accordance with section 6 of Rev. Proc. 2002-9 and enter the designated number ("82") for this automatic change in method in Line 1a of Form 3115.

SECTION 7. AUDIT PROTECTION

.01 If a taxpayer within the scope of this revenue procedure currently uses a method of accounting that treats credit card late fees as interest that creates or increases the amount of OID on a pool of credit card loans to which these fees relate, the issue of whether the taxpayer is properly treating its credit card late fees as OID on a pool of credit card loans will not be raised by the Commissioner in a taxable year that ends before December 31, 2003.

.02 If a taxpayer within the scope of this revenue procedure currently uses a method of accounting that treats credit card late fees as interest that creates or increases the amount of OID on a pool of credit card loans to which these fees relate and its use of that method is an issue under consideration (within the meaning of section 3.09 of Rev. Proc. 2002-9) in examination, before an appeals office, or before the U.S. Tax Court for any taxable year that ends before December 31, 2003, that issue will not be further pursued by the Service.

.03 Neither the audit protection provided in connection with a change in a taxpayer's method of accounting for credit card late fees that is properly made under section 6 of this revenue procedure, nor the audit protection provided under sections

7.01 and 7.02 of this revenue procedure, is a determination by the Commissioner that the taxpayer is properly accounting for any OID income on that pool of credit card loans. Thus, for example, the Service is not precluded from pursuing the issue of whether a taxpayer is properly accounting for its OID income (including any OID attributable to late fees) on its pool of credit card loans in accordance with § 1272(a)(6).

SECTION 8. EFFECT ON OTHER DOCUMENTS

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

SECTION 9. EFFECTIVE DATE

This revenue procedure is effective for taxable years ending on or after December 31, 2003.

DRAFTING INFORMATION

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