

## DEPARTMENT OF THE TREASURY INTERNAL REVENUE SERVICE WASHINGTON, D.C. 20224

June 21, 1999

Number: **199937031** Release Date: 9/17/1999

MEMORANDUM FOR DISTRICT DIRECTOR DISTRICT

ATTN: CHIEF, EXAMINATION DIVISION

FROM: CHIEF, BRANCH 9

CC:DOM:IT&A:9

SUBJECT: WITHDRAWAL OF APPLICATION FOR CHANGE IN

ACCOUNTING METHOD

In accordance with section 8.07(2) of Rev. Proc. 99-1, 1999 I.R.B. 6, 34, this memorandum advises you that a taxpayer within your district has withdrawn a Form 3115, Application for Change in Accounting Method. This document is not to be cited as precedent.

LEGEND:

<u>A</u> =

<u>B</u> =

C =

This memorandum advises you that a Form 3115 submitted on behalf of  $\underline{A}$  is withdrawn. A did not give any reason for the withdrawal.

A filed a Form 3115, Application for Change in Accounting Methods for permission to change its method of accounting for federal income tax purposes for legal expenditures made on behalf of clients. The partnership is a law firm engaged in providing legal services to its clients. The partnership incurs certain expenses on behalf of its clients which are termed "client expenses," and which clients are required to reimburse. The partnership divides the client expenses into two categories, "reimbursable service charges" and "out-of-pocket expenses". The partnership requested permission to change the accounting treatment of reimbursable service charges to the method of deducting the expenditures when paid and reporting reimbursements as income when payment is received from clients. The partnership requested permission to change the accounting treatment

of out of pocket expenses to the method of treating such expenditures as loans to clients. This method change would have been effective beginning with the taxable year beginning  $\underline{B}$ , and would have resulted in a positive § 481(a) adjustment (increase in taxable income) of \$ $\underline{C}$ .

Expenses incurred by an attorney on behalf of a client are not deductible if the attorney expects to be reimbursed, even if the reimbursement is contingent upon the success of the case. *Boccardo* v. *United States*, 12 Ct. Cl. 184, 186 (1987); Herrick v. Commissioner, 63 T.C. 562 (1975); *Canelo* v. *Commissioner*, 53 T.C. 217 (1969), aff'd, 447 F.2d 484 (9th Cir. 1971); *Silverton* v. *Commissioner*, T.C.M. 1977-198, aff'd, 647 F.2d 172 (9th Cir. 1981). This is because expenditures or advances made under an agreement that the taxpayer will be reimbursed therefor by another are in the nature of loans to that person. *Boccardo* at 186; See also *Electric Tachometer Corp.* v. *Commissioner*, 37 T.C. 158 (1961) (reimbursed corporate expenses held nondeductible loans).

At the time of the withdrawal, we had formed a tentatively adverse position on <u>A</u>'s proposed change in accounting treatment for reimbursable services charges. We had tentatively concluded that the reimbursable service charges should also be treated as loans to clients. The proposed accounting treatment for out-of-pocket expenses was viewed as correct. However, the partnership withdrew its entire application without changing the accounting treatment for out-of-pocket expenses.

If you have any questions on this matter, do not hesitate to call

at

Sincerely yours,

J. CHARLES STRICKLAND Chief, Branch 9 Office of Assistant Chief Counsel (Income Tax and Accounting)

CC:

Changes in Methods of Accounting Industry Specialist