



August 25, 2020

Mr. John Moriarty
Associate Chief Counsel
Income Tax & Accounting
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

Re: Tax Methods and Periods Priority Issues

Dear Mr. Moriarty:

The American Institute of CPAs (AICPA) commends the continued efforts of the Department of the Treasury (“Treasury”) and the Internal Revenue Service (IRS) to issue timely guidance related to Public Law 115-97, commonly referred to as the Tax Cuts and Jobs Act (TCJA or the “Act”)¹ as well as Public Law 116-136, the Coronavirus Aid, Relief and Economic Security Act (CARES Act).² The AICPA recognizes and appreciates the significant volume of guidance that Treasury and the IRS have issued in recent months and acknowledges that the government is continuing to work on numerous urgent matters related to the coronavirus pandemic.

The AICPA is pleased to submit comments on priority issues relating to tax methods and periods that are significantly affecting our members. Our focus in this letter is to provide recommendations that will reduce administrative burden on both taxpayers and the government. Specifically, we recommend that Treasury and the IRS provide guidance on the following issues:

- I. Automatic Change to Permit Taxpayers to Change to the Percentage-of-Completion Method
- II. Extension of Timeframe for Designated Automatic Accounting Method Change Number 231 due to Deferred Implementation of Accounting Standards Codification 606 for Private Companies
- III. Automatic Method Change for Commissions Expense to Change to Proper Method if No Fixed Liability at Year-end or if Amounts Constitute Deferred Compensation
- IV. Temporary Reliance on Regulations under Section 861³ to Determine Whether a Software Transaction is Properly Treated as a Sale of Inventory under Section 471

¹ Public Law 115-97, 131 Stat. 2054.

² Public Law 116-136.

³ Unless otherwise indicated, hereinafter, all section references are to the Internal Revenue Code of 1986, as amended, or to the Treasury Regulations promulgated thereunder.

V. Qualified Improvement Property Changes Filed under Designated Automatic Change Number 7 to be Viewed as Valid

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The AICPA is the world's largest member association representing the accounting profession, with more than 431,000 members in the United States and worldwide, and a history of serving the public interest since 1887. Our members advise clients on federal, state and international tax matters and prepare income and other tax returns for millions of Americans. Our members provide services to individuals, not-for-profit organizations, small and medium-sized businesses, as well as America's largest businesses.

We appreciate your consideration of our recommendations and welcome the opportunity to further discuss our comments. If you have any questions, please contact Connie Cunningham, Chair, AICPA Tax Methods and Periods Technical Resource Panel, at (310) 557-8544, or CCCunningham@bdo.com; Elizabeth Young, Senior Manager — AICPA Tax Policy & Advocacy, at (202) 434-9247, or elizabeth.young@aicpa-cima.com; or me at (612) 397-3071 or chris.hesse@CLAconnect.com.

Sincerely,



Christopher W. Hesse, CPA
Chair, AICPA Tax Executive Committee

cc: The Honorable David J. Kautter, Assistant Secretary for Tax Policy, Department of the Treasury
The Honorable Charles P. Rettig, Commissioner, Internal Revenue Service
The Honorable Michael J. Desmond, Chief Counsel, Internal Revenue Service
Ms. Wendy Friese, Tax Policy Advisor, Office of Tax Legislative Counsel, Department of the Treasury

AMERICAN INSTITUTE OF CPAs

Comments on Tax Methods and Periods Priority Issues

August 25, 2020

SPECIFIC COMMENTS

I. Automatic Change to Permit Taxpayers to Change to the Percentage-of-Completion Method

Overview

The adoption of Accounting Standards Codification (ASC) 606,⁴ which provides for the recognition of revenue when a seller satisfies its performance obligations, triggered a renewed focus on revenue recognition for many companies. As a result of ASC 606, taxpayers must closely analyze their contracts with customers to determine whether revenue for financial reporting purposes should be recognized over time or at a point in time. While the criteria for the required use of the percentage-of-completion method (PCM) under section 460 has not changed, many taxpayers that are presently implementing ASC 606 and have historically followed their financial accounting determination of revenue recognition for tax purposes have discovered that they have used impermissible methods of tax accounting by not applying PCM to their long-term contracts.

Recommendation

The AICPA recommends that Treasury and the IRS issue guidance permitting an automatic method change for taxpayers to change from any impermissible method of accounting for a long-term contract to the PCM. In addition, we recommend that the automatic change provides audit protection for taxpayers.

Analysis

The IRS previously provided an automatic change to the PCM in Rev. Proc. 2015-14. However, the automatic change was removed in subsequent releases of the List of Automatic Changes (the successors to Rev. Proc. 2015-14). Due to the renewed focus on appropriate revenue recognition as a result of ASC 606 and a desire by taxpayers to voluntarily comply with the appropriate tax accounting rules, the AICPA suggests that the IRS re-issue the automatic change, even if for a limited period.

⁴ ASC 606 is the new revenue recognition standard for financial reporting purposes that provides a robust framework for addressing revenue recognition issues under U.S. generally accepted accounting principles (GAAP). The standard was issued in May 2014 and the effective dates for the new guidance have been staggered for public and non-public entities.

Many taxpayers were not able to change to the PCM in the year of ASC 606 adoption since the effective date of ASC 606 for nonpublic entities was generally the first annual reporting period after December 15, 2018, effectively the 2019 calendar year financial statements.

In addition, nonpublic entities do not issue financial statements until after the end of the year, therefore, many taxpayers did not discover impermissible methods of tax accounting until after the point at which they could file a non-automatic accounting method change for the year of ASC 606 adoption. The Financial Accounting Standards Board (FASB) approved a deferral for the adoption of ASC 606. However, the deferral is only applicable to nonpublic entities that have not yet issued financial statements as of early June 2020. Due to operating agreements or loan covenants, many financial statements are required to be issued within 90 to 120 days after year end. Therefore, the ASC 606 deferral provided by the FASB may provide only limited relief.

Further, the required IRS user fee of \$10,800 for ruling on non-automatic accounting method changes can be cost-prohibitive for many companies. This user fee, combined with practitioner fees and the additional administrative burden of filing and receiving consent for a non-automatic method change, can create frustration for taxpayers that are already resource-constrained and discourage them from changing to a proper method of accounting.

The IRS has publicly stated that many of the automatic Internal Revenue Code (IRC) section 460 changes filed under Rev. Proc. 2015-14 improperly included section 481(a) adjustments. The potential volume of accounting method changes under section 460 combined with the encouragement of voluntary compliance for taxpayers should mitigate the concern that some taxpayers may not appropriately comply with all terms and conditions of such change. The benefit of audit protection is a critical component of voluntary compliance. The IRS provision of audit protection for section 460 changes to the PCM filed under the non-automatic procedures should be carried over to any automatic change under section 460 to the PCM.

II. Extension of Timeframe for Designated Automatic Accounting Method Change Number 231 due to Deferred Implementation of Accounting Standards Codification 606 for Private Companies

Overview

Designated automatic accounting method change number (DCN) 231, under section 16.11 of Rev. Proc. 2019-43 permits taxpayers to make federal income tax accounting method changes to a method under ASC 606 and International Financial Reporting Standards (IFRS) 15 (collectively “New Standards”). Specifically, in the year that a taxpayer adopts the New Standards, it may change its federal income tax recognition of identifying performance obligations, allocating transaction price to performance obligations, and/or considering performance obligations satisfied. The parameters of the automatic accounting method change provide that taxpayer can make the change in taxable years ending on or before May 10, 2021. At the time that the automatic accounting method change was issued, nonpublic entities were required to adopt the New Standards for the first annual reporting period after December 15,

2018, effectively the 2019 calendar year financial statements.⁵ On June 3, 2020, FASB issued ASU No. 2020-05 to extend by one year, the effective date for the adoption of the New Standards for nonpublic entities that had not issued financial statements as of June 3, 2020, to annual reporting periods after December 15, 2019 and interim reporting periods within annual reporting periods beginning after December 15, 2020.

Recommendation

The AICPA recommends that Treasury and the IRS provide guidance permitting taxpayers that do not adopt the New Standards until years beginning after December 15, 2019, to qualify for DCN 231 by updating the time for making the change to include taxable years ending on or before May 10, 2022.

Analysis

Updating the taxable years for which a taxpayer is permitted to make DCN 231 to taxable years ending on or before May 10, 2022, will permit taxpayers that defer the implementation of the New Standards to make an automatic accounting method change to conform their federal income tax recognition of certain of the New Standards. Updating the automatic accounting method change will permit any nonpublic entities that are able to defer the adoption of the New Standards the same ability to make automatic federal income tax changes as those public and nonpublic entities that adopted the New Standards prior to the deferral. Additionally, if the automatic method change is not updated, a number of non-automatic accounting method requests will be filed which will add an unnecessary burden to taxpayer, IRS exam, and IRS national office resources.

III. Automatic Method Change for Commissions Expense to Change to Proper Method if No Fixed Liability at Year-end or if Amounts Constitute Deferred Compensation

Overview

Many taxpayers that have implemented the new revenue recognition standard for financial reporting under ASC 606 must also change their recognition of commission expenses paid to employees and third parties. As part of their analysis, taxpayers may discover that their existing tax method of accounting with respect to commission liabilities is improper. For example, a taxpayer may find that commission liabilities have been treated as incurred prior to fixing of the liability under section 461. Presently, an accounting method change to correct the timing of commission liabilities must be made under the advance consent provisions under Rev. Proc. 2015-13.

Recommendations

The AICPA recommends that Treasury and the IRS modify the automatic accounting method change under section 14.01(1)(a)(i) of Rev. Proc. 2019-43 (deferred compensation) to include

⁵As of note public companies had an earlier adoption date.

sick pay, severance pay, commissions, and non-qualified deferred compensation to both employees and independent contractors.

Additionally, we recommend that Treasury and the IRS add a new automatic accounting method change under section 20.01 of Rev. Proc. 2019-43 (timing of incurring liabilities for employee compensation) to add a specific change for commissions and non-qualified deferred compensation paid to both employees and independent contractors.

Analysis

Modifying automatic changes under sections 14.01(1)(a)(i) and 20.01 of Rev. Proc. 2019-43 to also include sick pay, severance pay, commissions, and non-qualified deferred compensation and expanding them to apply to amounts paid to independent contractors will allow taxpayers to expeditiously comply with the requirements of sections 404(a)(5) and 461 and permit a broader scope of this automatic change for taxpayers. These types of changes are non-controversial and will further encourage compliance with proper tax accounting methods, and conserve taxpayer, IRS exam and IRS national office resources.

IV. Temporary Reliance on Regulations under Section 861 to Determine Whether a Software Transaction is Properly Treated as a Sale of Inventory under Section 471

Overview

The prevalence and variety of software transactions in commerce has increased the need for guidance regarding the tax accounting treatment of the transactions. There is no official guidance addressing whether and which software transactions with customers result in the sale of inventory under section 471 and give rise to costs being recovered as cost of goods sold under Treas. Reg. § 1.61-3.⁶

Recommendation

The AICPA recommends that until further guidance can be issued addressing the application of the tax accounting and character provisions of the IRC to software transactions, that Treasury and the IRS issue temporary guidance expressly permitting taxpayers to rely on the characterization of such transactions under existing Treas. Reg. § 1.861-18 and Prop. Reg. § 1.861-18.

⁶ Examples include a non-exclusive limited term license, non-exclusive perpetual license, downloadable with internet access, software that needs future upgrades to work appropriately (e.g., anti-virus computer software), mass produced, prepackaged software sold in an online/hosted environment, basic software that is customized for a particular client and provided via tangible medium, download, or online/hosted, nonstandard software that is developed for a specific customer or use, software provided as an output/deliverable of a services engagement (e.g., security or design), and the same software sold on tangible medium, available for download, or online (e.g., video games available at retail store, downloaded from company website, or use on hosted website).

Analysis

Treasury Reg. § 1.861-18 has provided guidance since 1998 for the classification of computer programs for purposes of applying the allocation and apportionment principles that define whether income is from a foreign or United States (U.S.) source. These regulations draw from general tax principles to classify transactions involving the transfer of computer programs as falling into one of four categories: (i) transfer of a copyright in the computer program; (ii) transfer of a copy of the computer program (a copyrighted article); (iii) provision of services for the development or modification of the computer program; or (iv) provision of know-how relating to computer programming techniques. Proposed Reg. § 1.861-18 issued in 2019 modifies and expands these principles for purposes of classifying the transfer of one of these items through a digital medium.

While the regulations under section 861 do not apply for purposes of the Code other than the sourcing rules, the regulations draw from general principles of tax law (e.g., the benefits and burdens of ownership test) to classify the transactions as sales, leases, licenses, or services. Therefore, it is reasonable for the IRS and Treasury to permit reliance on them for purposes of applying the tax accounting and characterization rules in other Code sections.

V. Qualified Improvement Property Changes Filed under Designated Automatic Change Number 7 to be Viewed as Valid

Overview

The CARES Act retroactively corrected the depreciable life of qualified improvement property (QIP) from 39-year property to 15-year property. On April 17, 2020, the IRS issued Rev. Proc. 2020-25, which provides procedural guidance allowing taxpayers to correct the treatment of QIP through amending returns or filing an automatic method change under DCN 244. Rev. Proc. 2020-25 modifies section 6.01(1)(c) of Rev. Proc. 2019-43 to exclude QIP placed in service after December 31, 2017 from the existing automatic method for impermissible to permissible changes in depreciation methods under DCN 7.

Recommendation

The AICPA recommends that Treasury and the IRS clarify that taxpayers that filed DCN 7 to correct the depreciation of their QIP and properly complied with the procedural requirements under section 6.01(1)(c) of Rev. Proc. 2019-43 are not required to file the automatic method change as DCN 244.

Analysis

Due to the changes associated with the CARES Act, taxpayers may have attempted to correct their treatment of QIP using DCN 7 rather than the new automatic change specific to QIP. As taxpayers are generally required to disclose more information under DCN 7 than DCN 244, broadening the method change procedures to allow taxpayers to correct their treatment of QIP

under either DCN 7 or DCN 244 will encourage greater compliance and prevent taxpayers from procedural foot-faults.