May 8, 2019

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

Re: Comments on Rev. Proc. 2018-31

Dear Mr. Dinwiddie:

The American Institute of CPAs (AICPA) is pleased to submit recommendations with respect to Rev. Proc. 2018-31, which provides a list of accounting method changes for which automatic consent is granted.

Specifically, the AICPA provides comments and recommendations in the following areas:

I. Modifications to the Procedural Rules for Automatic Method Changes
   1. Restore "scope limitation waiver" when new guidance is issued
   2. Automatic changes with no audit protection

II. Modifications to Current Automatic Accounting Method Changes under Rev. Proc. 2018-31
   1. Change for deferred compensation
   2. Change for liabilities for employee compensation
   3. Change for sale, lease or financing transactions

III. Additional Automatic Accounting Method Changes
   1. Change from an impermissible to permissible method of deducting deferred compensation and/or compensation under Treas. Reg. § 1.83-6 in the year included in the recipient's income
   2. Change from an impermissible to permissible method of accounting for income under the overall cash receipts and disbursements method (cash method) that conforms to section 451[1]

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

3. Change from an impermissible to permissible method for recognizing income from tenant allowances
4. Change from an impermissible to permissible method of accounting for liabilities under the overall cash method that conforms to section 461
5. Change from an impermissible to permissible method of accounting for liabilities under an overall accrual method that conforms to section 461
6. Change to the recurring item exception method for liabilities incurred under an overall accrual method of accounting
7. Change from one internal index method to another internal index method or from the inventory price index computation (IPIC) method to an internal index method for dollar-value last-in, first-out (LIFO) inventory

These recommendations include, but are not limited to, the following issues:

- Provide audit protection for taxpayers under exam when new guidance is issued;
- Include audit protection for any method change afforded automatic consent;
- Add commissions to the type of compensation eligible for the automatic consent procedures for deferred compensation, including adding automatic consent for a fiscal year taxpayer changing its method to comply with Treas. Reg. § 1.83-6;
- Provide cash method taxpayers with automatic consent to change from impermissible income or expense recognition methods to permissible methods;
- Provide automatic consent for method changes to comply with section 451(c);
- Provide automatic consent for an accrual method taxpayer to change from impermissible to permissible methods of applying the all-events test and economic performance for liabilities;
- Include automatic consent for a change to properly apply the recurring item exception for eligible liabilities; and
- Permit taxpayers to change from an impermissible to permissible method of accounting for recognizing income from tenant improvement allowances.

These comments were developed by the AICPA Revenue Procedure 2018-31 Working Group under the AICPA Tax Methods and Periods Technical Resource Panel and approved by the AICPA Tax Executive Committee.

The AICPA is the world's largest member association representing the accounting profession with more than 431,000 members in 137 countries 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.

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We appreciate your consideration of our recommendations and welcome the opportunity to further discuss our comments. If you have any questions, please contact Jennifer Kennedy, Chair, AICPA Tax Methods and Periods Technical Resource Panel, at (415) 498-5952, or jennifer.kennedy@pwc.com; or Elizabeth Young, Senior Manager – AICPA Tax Policy & Advocacy, at (202) 434-9247, or elizabeth.young@aicpa-cima.com or me at (408) 924-3508 or annette.nellen@sjsu.edu.

Sincerely,

Annette Nellen, CPA, CGMA, Esq.
Chair, AICPA Tax Executive Committee

cc: Mr. John Moriarty, Deputy Associate Chief Counsel, Income Tax & Accounting, Internal Revenue Service
Ms. Ellen Martin, Tax Policy Advisor, Office of Tax Legislative Counsel, Department of the Treasury
Ms. Wendy Friese, Tax Policy Advisor, Office of Tax Legislative Counsel, Department of the Treasury

AMERICAN INSTITUTE OF CPAs

Revenue Procedure 2018-31

BACKGROUND

Section 446(e) and the regulations thereunder require that a taxpayer who changes its method of accounting on the basis of which the taxpayer regularly computes income in keeping its books must, before computing taxable income under the new method, secure the consent of the Commissioner of the Internal Revenue Service (the "Commissioner"). Generally, a taxpayer must file a Form 3115, *Application for Change in Accounting Method*, to secure the Commissioner's consent to change a method of accounting.[2] For certain automatic accounting method changes prescribed in Rev. Proc. 2018-31, a taxpayer complying with all the applicable provisions of Rev. Proc. 2015-13 and Rev. Proc. 2018-31 has obtained the consent of the Commissioner to change its method of accounting under section 446(e) and the regulations thereunder.[3] To obtain the consent of the Commissioner for non-automatic method changes that are not eligible for automatic consent, a taxpayer must follow the rules outlined in Rev. Proc. 2015-13.

The AICPA previously provided comments on the accounting method change procedures under Rev. Proc. 2015-13 to the Internal Revenue Service (IRS) and the Department of the Treasury (Treasury) in a letter dated November 14, 2016.[4] As a follow-up to our previous letter, the AICPA appreciates the opportunity to provide additional comments on suggested accounting method changes and modifications to current changes in Rev. Proc. 2018-31. The AICPA is also providing comments on some key issues with respect to automatic accounting method changes that we believe may require clarification or modifications. These proposed changes and modifications will assist the IRS and Treasury in achieving their goals of encouraging prompt voluntary compliance with proper tax accounting method principles and promoting the public interest.

SPECIFIC COMMENTS

I. Modifications to the Procedural Rules for Automatic Accounting Method Changes

1. Restore "scope limitation waiver" when new guidance is issued

Overview:

The IRS has a long-standing practice of waiving the scope restrictions (now known as the eligibility requirements) to file automatic consent accounting method changes while providing audit protection for taxpayers under examination when adopting new guidance or new safe harbors.

[2] Treasury Reg. § 1.446-1(e)(3)(i). The Commissioner may prescribe administrative procedures for a taxpayer to change its method not withstanding paragraph (e)(3)(i) of this provision.

[3] Revenue Procedure 2015-13, section 9.

[4] See http://www.aicpa.org/Advocacy/Tax/DownloadableDocuments/AICPA-Comment-Letter-on-Rev-Proc-2015-13-11-14-16.pdf.

Recommendation

The AICPA recommends that guidance providing new safe harbors or new accounting method changes provide an exception to the no-audit protection (and two-year spread of a positive section 481(a) adjustment) for taxpayers under examination for a limited period of time to grant audit protection under section 8.01 of Rev. Proc. 2015-13 in these circumstances. The provision could begin when the new guidance is incorporated into Rev. Proc. 2018-31, or its successors.

Analysis

The AICPA applauds the IRS's approach under Rev. Proc. 2015-13 for expanding the opportunities to file automatic consent method change applications when taxpayers are under examination. However, the AICPA is concerned that when the IRS incorporates new accounting method changes under Rev. Proc. 2018-31 or its successors, the IRS has inadvertently omitted allowing audit protection for a limited time when adopting the new guidance. It appears that the separation of the audit protection provision from the eligibility provisions in Rev. Proc. 2015-13 may result in failure to grant audit protection for a limited time for new guidance. The approach in Rev. Proc. 2015-13 separates the eligibility requirement provisions (section 5) from the audit protection provisions (section 8).

When the IRS issues new guidance, it is in the interest of sound tax administration that taxpayers are afforded an opportunity to comply with the new guidance with audit protection for prior years, even if the section 481(a) adjustment is positive. To the extent the IRS does not provide audit protection, even for a limited time, it discourages taxpayers under examination from complying with new guidance for fear an examining agent may adjust an earlier year, resulting in interest and penalties.

Part of this concern is illustrated with the automatic change to adopt the tangible property regulations under Rev. Proc. 2017-30, a predecessor to Rev. Proc. 2018-31. Although the automatic change in section 11.08 of Rev. Proc. 2017-30 waived certain eligibility requirements for changes filed for tax years beginning before January 1, 2017 (e.g., the final year of a trade or business and a change for the same item in five taxable years), the new guidance did not provide audit protection for taxpayers under examination unless they qualified for another exception to obtain audit protection, such as filing in a three-month window. In contrast, in Rev. Proc. 2011-14 (as amended), the IRS waived all scope restrictions, which allowed all taxpayers under exam to file Form 3115 and obtain favorable terms and conditions, including audit protection. The omission of audit protection in Rev. Proc. 2017-30 for taxpayers under examination (unless they qualified for another exception) caused many taxpayers to rely on the transition period to continue to file method change applications for the tangible property regulations under the prior guidance simply to obtain audit protection.

2. Automatic changes with no audit protection

Overview

While not a new development, Rev. Proc. 2018-31 continues the policy in prior revenue procedures of denying audit protection for certain types of accounting method changes, regardless of whether the taxpayer is under examination or within a window period at the time of filing of the Form 3115.

Recommendations

The AICPA recommends that the IRS modify Rev. Proc. 2018-31 (or its successor) to eliminate the restriction against audit protection related to accounting method changes where audit protection is either denied or limited as follows:

- Certain types of accounting method changes that are implemented using a cut-off transition method;
- Accounting method changes where a cut-off transition approach applies, and only partial audit protection is granted; and
- Accounting method changes where audit protection is limited, but the change requires a section 481(a) adjustment.

The AICPA understands the reasons for restrictions on audit protection if a taxpayer is under IRS examination and does not meet an exception and is not recommending a change in such cases, other than in situations involving the issuance of new guidance (as described above); however, the AICPA believes that where a taxpayer otherwise is eligible for audit protection, such protection should not be denied.

Analysis

The IRS has a long-standing policy to monitor the propriety of the accounting methods employed by taxpayers by means of a "carrot-and-stick" approach. The AICPA believes this policy is counter-productive to the long-standing practice of providing incentives to encourage taxpayers to voluntarily request permission to correct improper methods of accounting. Under this approach, taxpayers generally receive more favorable treatment if they voluntarily correct an improper method of accounting than if the correction is imposed on the taxpayer by the IRS as part of an IRS examination of the taxpayer. Three of the primary components to this approach are (1) prospective application of the method change; (2) favorable spread period for an unfavorable section 481(a) adjustment; and (3) audit protection.

A taxpayer voluntarily requesting permission to correct an improper method of accounting is entitled to treat the taxable year for which the Form 3115 is filed as the year of change. In contrast, if a taxpayer is required to correct an improper method of accounting by the IRS in the course of an IRS examination, the year of change is possibly the earliest taxable year of the taxpayer that is open at the time of the adjustment. This difference in treatment affects whether the taxpayer is subject to interest and penalties with respect to the adjustment.

A taxpayer voluntarily requesting permission to correct an impermissible method of accounting receives a four-year spread of a positive section 481(a) adjustment resulting from the accounting method change, unless the taxpayer is under examination at the time that the Form 3115 is filed and the taxpayer is not within any of the exceptions set forth in Rev. Proc. 2015-13, in which case the spread period is two years. Alternatively, for certain types of accounting method changes, the taxpayer is entitled to a cut-off transition approach. In contrast, if a taxpayer is required to correct an improper method of accounting by the IRS in the course of an examination, the taxpayer is required to include the entire section 481(a) adjustment in taxable income in a single taxable year, normally the earliest open taxable year at the time of the examination. This approach applies even if the taxpayer is otherwise eligible for a cut-off transition approach.

A taxpayer voluntarily requesting permission to correct an improper method of accounting is entitled to audit protection with respect to the accounting method that is the subject of the Form 3115. As a result, the IRS may not on examination of the taxpayer require the taxpayer to change the same accounting method for an earlier taxable year than the taxable year for which the Form 3115 is filed. In contrast, if a taxpayer is required to correct an improper method of accounting by the IRS in the course of an examination, the taxpayer does not receive any type of audit protection and, as noted above, the taxpayer is subject to adjustment for the earliest taxable year of the taxpayer that is open at the time of the adjustment.

Under Rev. Proc. 2018-31, as well as in earlier automatic consent procedural guidance, taxpayers are denied audit protection in the case of several types of accounting method changes, regardless of whether the taxpayer is under examination by the IRS or is covered by an exception.

Such changes included in Rev. Proc. 2018-31 consist primarily of certain types of accounting method changes that are implemented using a cut-off transition method, and are: (1) section 6.03 – sale, lease or financing transactions; (2) section 6.08 – certain tenant construction allowances; (3) section 7.01 – research and experimental expenditures;[5] (4) section 16.11 – advance payments change in applicable financial statement (AFS); and (5) section 30.01 – de minimis original issue discount (OID).

There are also several types of accounting method changes where a cut-off transition approach applies, and only partial audit protection is granted. These method changes include: (1) section 5.01 – revocation of section 171(c) election; (2) section 23.04 – used vehicle alternative LIFO; (3) section 23.06 – change to IPIC; (4) section 24.02 – mark-to-market under section 475 to realization method; and (5) section 31.01 – revocation of section 1278(b) election.

Finally, there are several types of accounting method changes where audit protection is limited, but the change requires a section 481(a) adjustment. Method changes falling into this category include: (1) section 16.06 – credit card late fees; (2) section 16.08 – credit card cash advance fees; (3) section 21.01 – change from an improper method of inclusion of rental income or expense to inclusion in accordance with the rental agreement (section 467); and (4) section 26.03 – change in qualification as life/non-life insurance company (section 816(a)).

[5] See https://www.aicpa.org/Advocacy/Tax/DownloadableDocuments/AICPA-Section-174-Letter-Final.pdf for AICPA comments to the IRS and Treasury in a letter dated June 8, 2015.

The AICPA is concerned that the foregoing accounting method changes have been singled out for more harsh treatment than other types of accounting method changes. The accounting methods at issue are no more egregious than other types of accounting methods for which audit protection is granted. Moreover, the nature of the transition approach is irrelevant in assessing the need for audit protection.

If a taxpayer initiates an accounting method change through a voluntary Form 3115 filing, the taxpayer would disclose to the IRS that its prior accounting method was improper and could have been adjusted by the IRS had the use of such method been detected on examination. This risk is amplified because the taxpayer must provide a copy of the Form 3115 to the examining agent. In such circumstances, the taxpayer is inviting an adjustment by an IRS examination team, if the taxpayer does not receive audit protection as a result of a voluntary filing of an accounting method change request. Denying audit protection in the case where a cut-off transition approach is adopted because of a change in law is understandable; however, the accounting method changes for which audit protection currently is denied do not fall into that category.

Denying audit protection to taxpayers in any case where there is a voluntary filing of an accounting method change (outside of the restrictions when a taxpayer is under examination) is counter-productive to the IRS's stated goal of encouraging voluntary compliance. Taxpayers will have little incentive to voluntarily correct their improper methods of accounting and compliance is undermined. In most cases, the taxpayer's method has been used for many prior years and has withstood numerous audits without detection or adjustment and the taxpayer will not voluntarily change the method without audit protection. Alternatively, some taxpayers may make method changes without consent to avoid risk of detection. As a result, the "carrot-and-stick" approach to induce voluntary compliance is frustrated.

The AICPA is aware that specific technical issues or situations can exist in which taxpayers on either side of a transaction take inconsistent positions; however, the IRS could provide audit protection and condition it upon representation that the taxpayer is not aware of the other party's treatment and the present method was not established as part of a plan to defer federal income taxes. The AICPA understands the reasons for overall restrictions on audit protection if a taxpayer is under IRS examination and does not meet an exception. However, these comments are meant to address situations where audit protection is denied based on the nature of the accounting method change.

II. Modifications to Current Automatic Accounting Method Changes under Rev. Proc. 2018-31

1. Change for deferred compensation

<u>Overview</u>

Section 404(a)(5) permits an employer to deduct a liability for compensation paid or accrued on account of any employee under a plan deferring the receipt of such compensation in the taxable year in which the compensation is includible in the gross income of an employee participating in the plan. Section 404(d) similarly provides that deferred compensation paid to independent contractors is deductible in the year in which the compensation is includable in the gross income of the person participating in the plan. In Rev. Rul. 88-68, 1988-2 C.B. 117, the IRS ruled that compensation paid to an independent contractor after 2.5 months after the end of the taxable year in which the related services were provided is deferred compensation subject to section 404 and is deductible in the year in which the compensation is includable in the gross income of the independent contractor.

Section 14.01(1)(a)(i) and (ii) of Rev. Proc. 2018-31 permit an automatic accounting method change for bonuses and vacation pay. Specifically, an employer can make a change to deduct bonuses or vacation pay (or treat them as capitalizable if the employer is subject to capitalization under section 263A) "in the taxable year of the employer in which or with which ends the taxable year of the employee in which the bonus" or vacation pay are includible in the employee's gross income. The change is permitted if, by the end of the taxable year, all the events have occurred that establish the fact of the liability to pay a bonus or vacation pay. In addition, the amount of the liability is determinable with reasonable accuracy, and the bonuses or vacation pay are otherwise deductible, but are received by the employee after the 15th day of the 3rd calendar month after the end of that taxable year.

Recommendation

The AICPA requests that the IRS modify the automatic accounting method change under section 14.01(1)(a)(i) of Rev. Proc. 2018-31 (deferred compensation) to include sick pay, severance pay, commissions, and non-qualified deferred compensation to both employees and independent contractors within the scope of the automatic change.

Analysis

Modifying automatic changes under section 14.01(1)(a)(i) of Rev. Proc. 2018-31 to also include sick pay, severance pay, commissions, and non-qualified deferred compensation and expanding to apply to amounts paid to independent contractors will allow taxpayers to expeditiously comply with the requirements of section 404(a)(5) and permit a broader scope of this automatic change for taxpayers. An automatic change to permit a taxpayer to comply with the requirements of sections 404(a)(5) and (d) for bonuses, vacation pay, sick pay, severance pay, commissions and non-qualified deferred compensation generally is non-controversial and will further encourage compliance with proper tax accounting methods, and conserve taxpayer, IRS exam and IRS national office resources.

2. Change for liabilities for employee compensation

Overview

Treasury Reg. § 1.461-1(a)(2)(i) states that under an accrual method of accounting, a liability is incurred and generally taken into account for federal income tax purposes in the taxable year in which all the events have occurred that establish the fact of the liability, the amount of the liability can be determined with reasonable accuracy, and economic performance has occurred with respect to the liability. Treasury Reg. § 1.404(b)-1T, A2(b)(1) states that a plan, or method or arrangement, shall be presumed to be one deferring the receipt of compensation for more than a brief period of time after the end of an employer's taxable year to the extent that compensation is received after the 15th day of the third calendar month after the end of the employer's taxable year in which the related services are rendered ("the 2½ month period"). In Rev. Rul. 88-68, the IRS ruled that compensation paid to an independent contractor after 2.5 months after the end of the taxable year in which the related services were provided is deferred compensation subject to section 404 and is deductible in the year in which the compensation is includable in the gross income of the independent contractor.

Section 20.01(3) permits an automatic accounting method change for vacation pay, sick pay, and severance pay as incurred in the taxable year in which all events have occurred that establish the fact of the liability and the liability can be determined with reasonable accuracy. Under both sections 20.01(2) and (3), a taxpayer may change its method of accounting to:

- Treat the applicable compensation liability as incurred in the taxable year in which the related services are provided if all the events that establish the fact of the liability to pay the compensation have occurred by the end of the taxable year in which the related services are provided (and, in the case of vacation, sick, or severance pay the compensation vests in the taxable year the services are provided), and the compensation is received by the employee no later than the 15th day of the third calendar month after the end of the table year in which the related services are provided; or

- Treat the applicable compensation liability as incurred in the subsequent taxable year if all the events that establish the fact of the liability to pay the compensation occur in the taxable year subsequent to the taxable year in which the related services are provided.

Recommendation

The AICPA requests that the IRS modify the automatic accounting method change under sections 20.01(2) and (3) of Rev. Proc. 2018-31 (employee bonuses, vacation pay, sick pay, severance pay) to include commissions, as well as amounts paid to independent contractors, within the scope of the automatic change.

Analysis

Modifying the automatic change under section 20.01(2) of Rev. Proc. 2018-31 to include commissions and expanding the automatic changes under sections 20.01(2) and (3) to include compensation paid to independent contractors will allow taxpayers to expeditiously comply with the requirements of sections 461, 404(a)(5), and 404(d) and permit a broader scope of the automatic change for taxpayers. An automatic change to permit a taxpayer to comply with the requirements of sections 461, 404(a)(5) and 404(d) for commissions, bonuses, vacation pay, sick pay, and severance generally is non-controversial and will further encourage compliance with proper tax accounting methods, and conserve taxpayer and IRS national office resources.

3. Change for sale, lease or financing transactions

Overview

The automatic accounting method change under section 6.03 of Rev. Proc. 2018-31 applies to a taxpayer that wants to change its method of accounting from improperly treating property as:

- Sold by the taxpayer to properly treating property as leased or financed by the taxpayer;
- Leased by the taxpayer to properly treating property as sold or financed by the taxpayer;
- Financed by the taxpayer to properly treating property as sold or leased by the taxpayer;
- Purchased by the taxpayer to properly treating property as leased by the taxpayer; and
- Leased by the taxpayer to properly treating property as purchased by the taxpayer.

Under the terms of the automatic change, a cut-off method is mandated under which the change only applies to transactions entered into on or after the beginning of the year of change. Also, a taxpayer does not receive audit protection under section 8.01 of Rev. Proc. 2015-13.

Recommendations

The AICPA requests that the IRS modify the automatic accounting method change under section 6.03 of Rev. Proc. 2018-31 (sale, lease or financing transactions) to permit the change to occur with a section 481(a) adjustment instead of a cut-off method, and to permit a taxpayer to receive audit protection under section 8.01 of Rev. Proc. 2015-13.

The AICPA recommends expanding the scope of the automatic accounting method change for leases so that a taxpayer may file a change to properly account for its leases, make the change with a section 481(a) adjustment without having to substantiate that its method of treating the transaction is consistent with the method used by the counterparty to the transaction, and obtain audit protection.

Alternatively, if the IRS does not broadly expand the scope of the automatic accounting change as described, the AICPA recommends broadening the scope for a limited period of time, for the year the new standard (discussed below) is effective, and for a year or two afterward, as has been done for prior changes. For example, the IRS provided waivers to some of the general eligibility rules to assist taxpayers in complying with the new rules under the tangible property regulations issued in 2013 and 2014.

Analysis

If a taxpayer wants to change its method of accounting for sale, lease or financing transactions entered into before the beginning of the year of change, and make the change with a section 481(a) adjustment, it must file a Form 3115 under the non-automatic change procedures of Rev. Proc. 2015-13. In order to obtain the accounting method change, the taxpayer must substantiate that its method of treating the transaction is consistent with the method used by the counterparty to the transaction by submitting, with its Form 3115, the name of the counterparty to the transaction, and a representation, signed under penalties of perjury, from the counterparty that provides the method of accounting for the agreement used by the counterparty for federal income tax purposes.

On February 25, 2016, the FASB issued Accounting Standards Update No. 2016-02, *Leases* (*Topic 842*). The new guidance establishes the principles to report transparent and economically neutral information about the assets and liabilities that arise from leases. The tax rules governing leasing transactions will not change; however, as taxpayers apply the new financial leasing standards to their transactions, they may discover that their existing tax methods of accounting for their leases are incorrect and require an accounting method change. In addition to potentially determining the misclassification of leases, taxpayers may find discrepancies in the lease acquisition costs capitalized for financial purposes compared to the amounts required to be capitalized for tax purposes. In addition, taxpayers may find discrepancies in determining the amount of rent expense for true leases and interest expense for capital leases that are deducted for tax purposes versus financial purposes. We expect that a substantial number of taxpayers will need to request a change in method of accounting to correct the tax treatment of their leases.

Broadening the scope of availability and allowing taxpayers to make the changes under the automatic accounting method change provisions will significantly reduce the burdens on taxpayers necessary to change their accounting methods to comply with proper tax methods. It will also significantly reduce the burden on the government due to the anticipated high volume of requests.

III. Additional Automatic Accounting Method Changes

1. Change from an impermissible to permissible method of deducting deferred compensation and/or compensation under Treas. Reg. § 1.83-6 in the year included in the recipient's income

Overview

Section 404(a)(5) permits an employer to deduct a liability for compensation paid or accrued on account of any employee under a plan deferring the receipt of such compensation in the taxable year in which the compensation is includible in the gross income of an employee participating in the plan. Section 83(h) and Treas. Reg. § 1.83-6 have a similar provision allowing the deduction of compensation for an employer in the year which includes the year that recipient includes the compensation into income.

Recommendation

The AICPA recommends that method changes eligible for automatic consent include a change for fiscal year taxpayers to correctly deduct compensation in accordance with Treas. Reg. § 1.83-6.

Analysis

Taxpayers with a fiscal year may improperly deduct deferred compensation or compensation in its fiscal tax year that precedes the year in which the recipient employee includes the compensation in his/her income.

Currently, the only remedy to correct this issue is to file a non-automatic method change. This limitation creates an additional administrative burden and expense to the employer to correct an issue where the law is well established, and where the IRS typically grants consent to the requested method change. Permitting automatic consent for taxpayers that improperly deduct compensation to change to properly apply the rules under sections 404 and 83 will increase compliance with the rules and reduce administrative burden for both the taxpayer and government.

2. Change from an impermissible to permissible method of accounting for income under the overall cash receipts and disbursements method (cash method) that conforms to section 451

Overview

Treasury Reg. § 1.446-1(c)(1)(i) states that generally, under the cash receipts and disbursements method, all items which constitute gross income (whether in the form of cash, property, or services) are included for the taxable year in which actually or constructively received. Section 451(a) states that the amount of any item of gross income shall be included in the gross income for the taxable year in which received by the taxpayer unless, under the method of accounting used in computing taxable income, such amount is to be properly accounted for as of a different period. Treasury Reg. § 1.451-2 explains how a taxpayer may have constructive receipt of income although such income is not actually reduced to the taxpayer's possession.

Recommendation

The AICPA requests that Rev. Proc. 2018-31 or its successors allow automatic consent for cash method taxpayers to change from impermissible to permissible methods for recognizing income under section 451. Specifically, the change would permit a taxpayer using the overall cash method of accounting to make a change from an impermissible method to a method of including income in the year in which it is actually or constructively received.

Analysis

A change from an impermissible to a permissible cash method of recognizing income will permit an automatic change and allow taxpayers to expeditiously comply with the requirements of section 451. The scope of such an automatic method change could be limited to those income items for which no other section is applicable (e.g., section 467). Such a change to comply with section 451 generally is straightforward and will further encourage compliance with proper tax accounting methods, conserve taxpayer and IRS national office resources, and significantly reduce the burden and costs associated with filing the method change, especially for small taxpayers.

Changes to comply with Section 451(b) and ASC 606

Overview

Section 451(b), as amended, significantly modifies the prior income recognition rules, potentially rendering certain current methods used by taxpayers impermissible. The new provisions under section 451(b) will require a substantial number of taxpayers, regardless of overall method of accounting or whether they have an AFS, to request a change in method of accounting for income recognition for one or more items of income.

Recommendation

The AICPA recommends that the IRS and Treasury issue the following procedural guidance:

- Substantive and procedural guidance addressing the implications of the interaction of section 451(b) and ASC 606;
- Automatic accounting method change to comply with section 451, including taxpayers excluded from the scope of Rev. Proc. 2018-60 (e.g., taxpayers without an AFS);
- Substantive and procedural guidance addressing the tax implications of a taxpayer's future changes in taxpayer's financial accounting revenue recognition methods; and
- Clarification that no change in accounting method is required if a taxpayer is presently on a permissible method that remains permissible under sections 451(b) and 451(c).

We also recommend the procedural guidance permit a taxpayer using an overall accrual method of accounting to utilize the recommended new automatic method changes to comply with section 451, regardless of whether the taxpayer has an AFS. Additionally, procedural guidance should include the option for a taxpayer to file a non-automatic method change request to obtain a ruling as to whether its proposed method of accounting is in accordance with section 451(b).

Finally, the IRS and Treasury should provide automatic consent to a taxpayer to change its method of accounting under section 451(c), similar to the automatic consent to change to or from the deferral method and/or full inclusion method, as provided in Rev. Proc. 2004-34.

Analysis

We anticipate that most requested accounting method changes to comply with section 451 will be straightforward once the IRS and Treasury provide substantive guidance under section 451(b) and implemented using the automatic method change procedures in Rev. Proc. 2018-60. However, due to the technical uncertainty arising from the new provisions under section 451, certain taxpayers may desire affirmative confirmation that their proposed method of accounting complies with the new provisions. Taxpayers should retain the ability to file a non-automatic method change request to seek a ruling, with attendant audit protection, as to whether their proposed method of accounting complies with section 451.

Guidance related to future changes in a taxpayer's financial accounting method of recognizing revenue

Overview

ASC 606 provides a five-step model for revenue recognition for financial accounting purposes:

- Identify the contract;
- Identify the performance obligations;
- Determine the transaction price;
- Allocate the transaction price among embedded performance obligations; and

- Recognize revenue when/as each performance obligation if satisfied.

Following the initial implementation of ASC 606, taxpayers may have future changes to their financial accounting revenue recognition methods, including the following:

- Identification of new or changing performance obligations;
- Changes to the determination of the transaction price;
- Changing allocation of the transaction price among the embedded performance obligations;
- Change in timing of revenue recognition for one or more embedded performance obligations.

Section 451(b) provides that for an accrual basis taxpayer, the all events test with respect to any item (or portion thereof) shall not be treated as met any later than when the item is taken into account on the taxpayer's AFS. The analysis of section 451(b) requires a taxpayer to analyze the revenue recognized on its AFS.

Recommendations

The IRS and Treasury should clarify whether future changes in a taxpayer's financial accounting method of recognizing revenue (as described above) are changes in accounting method requiring the taxpayer to file a Form 3115 or changes in underlying fact not requiring the taxpayer to file a Form 3115.

If a change in the taxpayer's method of recognizing revenue for financial accounting purposes is treated as a change in accounting method for tax purposes, we recommend implementation of such a change using the automatic method change procedures with audit protection and a section 481(a) adjustment.

Analysis

There is uncertainty as to whether changes in a taxpayer's financial accounting method of recognizing revenue are changes that necessitate the filing of Form 3115 or are underlying changes in facts. Taxpayers need clarity on whether a change in method is required due to the implementation of ASC 606. If a method change is required, allowing the automatic method change procedures to apply with audit protection will alleviate the administrative burden when compared with non-automatic change filings.

Waiver of eligibility rules under section 5.01(1) of Rev. Proc. 2015-13

Overview

The eligibility rules under section 5.01(1) of Rev. Proc. 2015-13 list several conditions that generally preclude taxpayers from making an automatic accounting method change (such as a change for the final year of the trade or business or a change requested for the same item during any of the five taxable years ending with the year of change). For a limited period of time, Rev.

Proc. 2018-60 has waived the eligibility for changes for the same item during any of the five taxable years ending with the year of change.

Recommendation

The AICPA requests waiver of all of the eligibility rules under section 5.01(1).

Analysis

An eligibility waiver of section 5.01(1)(d) of Rev. Proc. 2015-13, which prohibits a change in the final year of the trade or business, will permit taxpayers to comply with the new provisions in section 451(b) without the requirement of filing a non-automatic accounting method change. The IRS provided a similar waiver to assist taxpayers in complying with the substantial new rules under the tangible property regulations issued in 2013 and 2014.

Audit Protection

Overview

Taxpayers that file a Form 3115 while under examination generally do not receive audit protection or the four-year spread period of a positive section 481(a) adjustment under section 8.02(1) and section 7.03(3)(b) of Rev. Proc. 2015-13 unless the taxpayer files the Form 3115 pursuant to an exception described in sections 8.02(1)(a) – (f) of Rev. Proc. 2015-13.

Recommendation

We request that the IRS modify Rev. Proc. 2018-60 to allow a taxpayer under examination to file an accounting method change and obtain audit protection and, if the taxpayer under examination has a positive section 481(a) adjustment, allow utilization of a four-year spread period.

Analysis

We applaud the provision in Rev. Proc. 2018-60 that enables taxpayers that filed a non-automatic Form 3115 to comply with section 451(b) on or before November 29, 2018 for a taxable year beginning after December 31, 2017 to maintain audit protection if they qualified for and filed under a provision providing audit protection at the time the non-automatic Form 3115 was filed. However, a taxpayer filing a change under Rev. Proc. 2018-60, that has not previously filed the requested change as a non-automatic change on or before November 29, 2018, does not receive audit protection. Providing audit protection for taxpayers is important, otherwise the taxpayer is subject to adjustment for the earliest taxable year open under the statute of limitations at the time of the adjustment. Limiting or denying audit protection to taxpayers under examination is counter-productive to the IRS's goal of voluntary compliance. Providing audit protection to taxpayers who have not previously filed the requested change on or before November 29, 2018 will alleviate administrative burden and provide for the same benefits as those taxpayers who had previously filed before that date.

Clarification of no change in method

Recommendation

The AICPA suggests that the IRS and Treasury clarify that a taxpayer whose method was permissible under section 451 prior to amendment and remains permissible under section 451(b), as amended, is not required to file a Form 3115 to comply with section 451(b).

Analysis

There is uncertainty for taxpayers as to whether a change in law requires the filing of a change in accounting method, even if the method is permissible under both the old and new laws. It is important for taxpayers to have clarity on whether they need to fulfill the filing requirements associated with Form 3115 if the IRS and Treasury require a method change in this circumstance.

Section 451(c) method changes

Automatic Consent

Recommendation

The AICPA recommends that the IRS and Treasury provide automatic consent for a change to defer advance payments under section 451(c). Additionally, for taxpayers currently using the deferral method under Rev. Proc. 2004-34, the AICPA recommends that if the government believes taxpayers must change their method of accounting to the method under section 451(c), such change is effectuated by attaching a statement to the return and not by filing a Form 3115.

Analysis

Many taxpayers, particularly small taxpayers, may overlook the filing requirement, if any, because there is no actual change in method. Any filing requirement is a trap for the unwary; we recommend granting relief for any failure to comply with any filing requirement that the government might impose for the first tax year for which section 451(c) is effective.

481(a) Adjustment

Recommendations

The AICPA requests that the IRS modify the automatic accounting method change under section 16.10 of Rev. Proc. 2018-31 (Advance payments – change in applicable financial statements) to permit the change to be made with a section 481(a) adjustment instead of a cut-off method.

Alternatively, if the IRS does not broadly modify the term of the automatic accounting change to permit the change with a section 481(a) adjustment, the AICPA recommends modification of this term for a limited period, including the year the taxpayer adopts the ASC 606 standards, and for a year or two afterward.

Analysis

This accounting method change provides automatic consent to taxpayers presently deferring advance payments under Rev. Proc. 2004-34 to change to the method of deferral of such advance payments in the taxpayer's AFS. Under the terms of the automatic change, a cut-off method is used under which the change only applies to advance payments received on or after the beginning of the year of change. Due to the new revenue recognition standards under ASC 606, we expect that a substantial number of taxpayers will need to request a change in method of accounting to conform their tax deferral of advance payments to their financial statement deferral changed pursuant to adoption of ASC 606.

A taxpayer adopting ASC 606 will likely need changes both to comply with section 451(b) and to comply with a new method of deferring advance payments in its AFS. It is possible that a taxpayer adopting ASC 606 is making cumulative adjustments in its book revenue that may not separate earned from unearned revenue. Implementing a method change to comply with section 451(b) with a section 481(a) adjustment while required to implement a method change to comply with the new book deferral method on a cut-off basis will create administrative burdens and increased compliance costs. Modifying section 16.10 of Rev. Proc. 2018-31 to permit taxpayers to make the automatic change to conform to their method of recognizing advance payments in their AFS with a section 481(a) adjustment will reduce unnecessary administrative and compliance burdens.

3. Change from an impermissible to permissible method for recognizing income from tenant allowances

Overview

Treasury Reg. § 1.446-1(c)(1)(ii)(A) states that generally, under an accrual method, income is included for the taxable year when all the events have occurred that fix the right to receive the income and the amount of the income can be determined with reasonable accuracy. Section 451(a) states that the amount of any item of gross income shall be included in the gross income for the taxable year in which received by the taxpayer unless, under the method of accounting used in computing taxable income, such amount is to be properly accounted for in a different period. Treasury Reg. § 1.451-1 provides that under an accrual method of accounting, income is includible in gross income when all the events have occurred which fix the right to receive such income and the amount thereof can be determined with reasonable accuracy. Pub. L. No. 115-97, commonly referred to as the Tax Cuts and Jobs Act (TCJA or "the Act") substantially revised the revenue recognition rules applicable for tax purposes under section 451 effective for taxable years beginning after December 31, 2017. Under new section 451(b), all the events that fix the right to receive income will occur the earlier of when: (1) the required performance occurs; (2) payment is due; (3) payment is received; or (4) revenue is recognized in the taxpayer's AFS.

Recommendation

The AICPA requests that if the IRS does not implement the recommendation above to permit an automatic accounting method change for a taxpayer using an overall accrual method of accounting to change to a permissible method of accounting for income that conforms to section 451, the IRS permits a taxpayer using an impermissible method of accounting for recognizing income from tenant allowances to automatically change to a permissible method.

Analysis

The automatic change to a permissible method by a taxpayer using an impermissible method of accounting for recognizing income from tenant allowances would allow a taxpayer to include the tenant allowances in income when the all events test is met in accordance with section 451 and the regulations thereunder.

For financial accounting purposes, certain tenant allowances are amortized over the life of the lease as an offset to lease expense. Some taxpayers may inadvertently follow the financial accounting treatment. To the extent that section 110 does not apply to the tenant allowance and the taxpayer has the benefits and burdens of ownership of the property constructed with the allowance, the allowance is recognized for federal income tax purposes when the all events test is met.

4. Change from an impermissible to permissible method of accounting for liabilities under the overall cash method that conforms to section 461

Overview

Treasury Reg. § 1.446-1(c)(1)(i) provides that under the cash receipts and disbursements method, expenditures are to be deducted for the taxable year in which actually made. Section 461(a) states that the amount of any deduction or credit shall be taken for the taxable year which is the proper taxable year under the method of accounting used in computing taxable income. Treasury Reg. § 1.461-1(a)(1) states that under the cash receipts and disbursements method of accounting, amounts representing allowable deductions shall, as a general rule, be taken into account for the taxable year in which paid.

Recommendation

The AICPA requests that the list of automatic method changes include a change for a cash method taxpayer to change from an impermissible to a permissible method of accounting for liabilities.

Analysis

An automatic change from an impermissible to a permissible method of recognizing liabilities under the cash method when paid does not currently exist. The change would permit a taxpayer using the overall cash method of accounting to change from an impermissible method to a method of recognizing liabilities in the year in which the liabilities are paid in accordance with section 461.

The IRS could limit the scope of the automatic method change to those liabilities for which no other section is applicable (e.g., sections 467 or 404). Such a change to comply with section 461 generally would encourage simplification and further compliance with proper tax accounting methods, as well as conserve taxpayer and IRS national office resources, and significantly reduce the burden and costs associated with filing the method change, especially for small taxpayers.

5. Change from an impermissible to permissible method of accounting for liabilities under an overall accrual method that conforms to section 461

Overview

Section 461(a) states that the amount of any deduction or credit shall be taken for the taxable year which is the proper taxable year under the method of accounting used in computing taxable income. Treasury Reg. § 1.461-1(a)(2)(i) states that under an accrual method of accounting, a liability is incurred, and generally is taken into account for federal income tax purposes, in the taxable year in which all the events have occurred that establish the fact of the liability, the amount of the liability can be determined with reasonable accuracy, and economic performance has occurred with respect to the liability. Treasury Reg. § 1.446-1(c)(1)(ii)(A) contains similar language. Economic performance is determined under section 461(h) and Treas. Reg. § 1.461-4 and § 1.461-5.

Recommendation

The AICPA requests that the IRS permit an automatic accounting method change under section 461 for accrual method taxpayers from an impermissible to a permissible method of accounting.

Analysis

An automatic change from an impermissible to a permissible method of recognizing liabilities under the accrual method does not currently exist. The change would allow a taxpayer using an overall accrual method of accounting to make a change from an impermissible method to a method of recognizing liabilities in the taxable year in which all the events have occurred that: (1) establish the fact of the liability; (2) the amount of the liability can be determined with reasonable accuracy; and (3) economic performance has occurred with respect to the liability.

If the IRS has concerns as to whether a taxpayer is changing to a proper method of accounting, the automatic change could require the submission of additional information, such as a full and complete description of the item for which the change is being made. This information could include how the all-events test and economic performance applies to the item under the facts and circumstances of the taxpayer's trade or business, similar to the information required when making a change from the cash method to an accrual method for specific items under section 15.09 of Rev. Proc. 2018-31. The IRS could also require taxpayers to provide the legal basis supporting the proposed method for the item being changed (currently question 16 on Form 3115 revised December 2018).

A change from an impermissible to a permissible accrual method of recognizing liabilities will permit a broader scope for an automatic change for taxpayers that are not using the cash method of accounting for the specific item (for which an automatic change is available under section 15.09

of Rev. Proc. 2018-31) to expeditiously comply with the requirements of section 461. The scope of the automatic method change could be limited to those liabilities for which no other section is applicable (e.g., sections 467 or 404). A change to comply with section 461 generally is straightforward and will further encourage compliance with proper tax accounting methods, and conserve taxpayer and IRS national office resources.

6. Change to the recurring item exception method for liabilities incurred under an overall accrual method of accounting

<u>Overview</u>

Section 461(a) states that the amount of any deduction or credit shall be taken for the taxable year which is the proper taxable year under the method of accounting used in computing taxable income. Section 461(h)(3) provides a limited exception from the economic performance rules for certain recurring items. Under the recurring item exception, an item shall be treated as incurred during any taxable year if—

(i) the all events test with respect to such item is met during such taxable year;

(ii) economic performance with respect to such item occurs within the shorter of
  (a) a reasonable period after the close of such taxable year, or
  (b) 8½ months after the close of such taxable year,

(iii) such item is recurring in nature and the taxpayer consistently treats items of such kind as incurred in the taxable year in which the requirements of clause (i) are met, and

(iv) either
  (a) such item is not a material item, or
  (b) the accrual of such item in the taxable year in which the requirements of clause (i) are met results in a more proper match against income than accruing such item in the taxable year in which economic performance occurs.

Treasury Reg. § 1.461-5(b)(1) generally mirrors this language but specifies that a reasonable period after the close of such taxable year is the date the taxpayer files a timely (including extensions) return for that taxable year. Section 20.11 of Rev. Proc. 2018-31 permits an automatic accounting period change related to the recurring item exception, but the change appears confined to situations in which a taxpayer is improperly using the recurring item exception even though the liability is material or does not result in more proper matching of income. The automatic change permits a taxpayer to change from the recurring item exception only.

<u>Recommendations</u>

The AICPA recommends that Rev. Proc. 2018-31 or its successor include automatic consent for a taxpayer otherwise properly applying the accrual method of accounting for liabilities to change to properly apply the recurring item exception under section 461(h)(3) and Treas. Reg. § 1.461-5.

If the IRS does not expand automatic consent for all items that could fit within the recurring item exception, the IRS could limit automatic consent to those items that are deemed to meet the better matching rule under Treas. Reg. § 1.461-5(b)(5)(ii) (e.g., rebates and refunds; awards, prizes, jackpots; insurance, warranty, and service contracts; and taxes).

Analysis

Automatic consent should apply to method changes for refunds and sales returns. To address any concerns, the IRS could limit the ruling to provide consent, but the method change is not a determination by the Commissioner that the taxpayer has properly applied the recurring item exception method or that the liability met the all events test during the taxable year. A change to the recurring item exception generally is straightforward, will conserve taxpayer and government resources, and will permit an automatic change that does not currently exist, except for rebates and allowances. The change will allow taxpayers to expeditiously change to a permitted method of accounting under section 461(h)(3).

7. Change from one internal index method to another internal index method or from the inventory price index computation method to an internal index method for dollar-value LIFO inventory

Overview

Treasury Reg. § 1.472-8(e)(1) provides that a taxpayer may ordinarily use only the double-extension method for computing the base-year and current-year cost of a dollar-value inventory pool.

Additionally, under Treas. Reg. § 1.472-8(e)(1), taxpayers may use the double-extension method, an index (sampling) method, or the link-chain method to compute an index for a dollar-value LIFO pool, subject to review. Under each of these methods, a taxpayer uses its internal unit costs for items in inventory to compute the index. These methods are often referred to as internal index methods.

Recommendation

The AICPA requests that the IRS provide the following automatic accounting method changes for dollar-value LIFO inventory:

- From one internal index method (i.e., double-extension, index, link-chain) to another internal index method;
- From the IPIC method to an internal index method.

Analysis

When the double-extension method is impractical because of technological changes, the extensive variety of items, or extreme fluctuations in the variety of the items, in a dollar-value pool, a taxpayer may use an index method for computing all or part of the LIFO value of the pool. The taxpayer may compute the index by double-extending a representative portion of the inventory in a pool or by using other sound and consistent statistical methods. The index used must be appropriate to the inventory pool to which it is applied. The taxpayer must demonstrate the appropriateness of the method of computing the index and the accuracy, reliability, and suitability of the use of the index in connection with the examination of the taxpayer's income tax returns. The use of any link-chain method is approved for taxable years beginning after December 31, 1960, only when the taxpayer can demonstrate that the use of either an index method or the double-extension method is impractical or unsuitable in view of the nature of the pool.

Currently, a taxpayer changing from a non-IPIC (i.e., internal index) LIFO inventory method to the IPIC method may file an automatic method change under section 23.06 of Rev. Proc. 2018-31, but a taxpayer changing from one internal index method to another internal index method or from the IPIC method to an internal index method must file a non-automatic method change. The IRS national office routinely grants consent to taxpayers requesting these changes under the non-automatic change procedures. Permitting taxpayers to make these changes under the automatic consent procedures would conserve IRS national office resources and significantly reduce the burden and costs associated with filing the method change, especially for small taxpayers.

If the IRS has concerns as to whether a taxpayer is changing to a proper method of accounting, the automatic change could require the submission of additional information. This information may include a full and complete description of the particular link-chain method or the method used in computing the index. This would demonstrate the use of sound and consistent statistical methods and demonstrate that the use of the double-extension method is impractical or unsuitable in view of the nature of the pool. Alternatively, the IRS could limit the ruling to provide consent that is not a determination by the Commissioner of the IRS that the taxpayer has changed to a proper internal index method.