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AN ALERT FROM THE BDO FEDERAL TAX PRACTICE

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SUBJECT

IRS REQUESTS COMMENTS ON TAX ACCOUNTING METHOD CHANGE PROCEDURES TO NEW FINANCIAL REVENUE RECOGNITION STANDARDS

SUMMARY

The IRS and the Treasury Department recently issued Notice 2017-17 seeking to invite comments on a proposed revenue procedure that, if finalized, will provide procedures by which a taxpayer may request IRS consent to change a method of accounting for recognizing income when the change is made for the same taxable year for which the taxpayer adopts the new financial accounting revenue recognition standards, and the change is made as a result of, or directly related to, the adoption of the new revenue recognition standards. In addition, the Notice solicits comments on various issues of conformity between the new standards and the Internal Revenue Code and regulations.

DETAILS

Background

On May 28, 2014, the Financial Accounting Standards Board (FASB) and the International Accounting Standard Board (IASB) jointly announced new financial accounting standards for recognizing revenue (new standards), titled "Revenue from Contracts with Customers." See FASB Update No. 2014-09 and IASB International Financial Reporting Standard (IFRS) 15. The new standards are effective for publicly-traded entities, certain not-for-profit entities, and certain employee benefit plans for annual reporting periods beginning after December 15, 2017. For all other entities, the new standards are effective for annual reporting periods beginning after December 15, 2018. Early adoption is allowed for reporting periods beginning after December 15, 2016. See FASB Update No. 2015-14, "Revenue from Contracts with Customers (Topic 606), Deferral of the Effective Date." Since the joint announcement, FASB and IASB have revised the new standards and provided guidance on how to implement the new standards in certain situations.

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See, e.g., FASB Update No. 2016-08, “Principal versus Agent Considerations (Reporting Revenue Gross versus Net)”; FASB Update No. 2016-10, “Identifying Performance Obligations and Licensing”; FASB Update No. 2016-12, “Narrow-Scope Improvements and Practical Expedients”; and FASB Update No. 2016-20, “Technical Corrections and Improvements to Topic 606, Revenue from Contracts with Customers.”

Subsequently, on June 15, 2015, the Treasury Department and the IRS issued Notice 2015-40, which requested comments on federal tax accounting issues related to the adoption of the new standards, including whether the new standards are permissible methods of accounting for federal income tax purposes, the types of accounting method change requests that might result from adopting the new standards, and whether the current procedures for obtaining IRS consent to change a method of accounting are adequate to accommodate those requests.

REQUEST FOR COMMENTS

Comments on Conformity between New Standards and the Internal Revenue Code and Regulations

Notice 2017-17 discusses that the adoption of the new standards may create or increase differences between financial accounting and tax accounting rules. As such, the Treasury Department and the IRS recognize that there is interest in clarifying whether the new standards are permissible methods of accounting that may be used for federal income tax purposes. Accordingly, comments are being solicited on the following specific issues relating to conformity:

1) To what extent would using the new standards for federal income tax purposes result in acceleration or deferral of income under section 451 or other income provisions of the Code?

2) What industry and/or transaction-specific issues might arise as a result of the new standards that may need to be addressed in future guidance?

3) To what extent do the new standards deviate from the requirements of section 451? In what situations should the IRS allow taxpayers who adopt the new standards to follow their book method of accounting for tax purposes (for example, where income is always accelerated)?

4) To what extent do the rules regarding allocation of standalone sales price and transaction price in the new standards affect taxpayers' ability to satisfy their tax obligations?

The Notice indicates that the government is considering addressing issues of conformity between the new standards and the Internal Revenue Code and regulations in future guidance.

Comments on Procedures for Method Changes to New Standards

Under section 446(e) and the regulations thereunder, a taxpayer must secure the consent of the Commissioner before changing a method of accounting for any item for federal income tax purposes. Changes in method of accounting are generally implemented through filing a Form 3115, Application for Change in Accounting Method. The IRS is anticipating that many taxpayers will request consent to change a method of accounting for one or more items of income as a result of, or directly related to, the adoption of the new revenue standards for the same taxable year that the new standards are adopted for financial accounting purposes (a “qualifying same-year method change”).

Notice 2017-17 sets forth a proposed revenue procedure for obtaining IRS automatic consent to make a qualifying same-year method change. Taxpayers requesting consent for automatic changes for which existing guidance (including Rev. Proc. 2015-13 and Rev. Proc. 2016-29 or its successor) already provides automatic change procedures must use the existing automatic change procedures to make a request. With respect to qualifying same-year method changes for which existing guidance does not provide automatic change procedures, but that comply with section 451 of the Code or other guidance regarding the taxable year of inclusion of income, the taxpayer must make the change under the proposed revenue procedure. In general, the IRS contemplates that a qualifying same-year method change is implemented with a section 481(a) adjustment. However, a cut-off basis is currently proposed for a taxpayer with one or more separate and distinct trade(s) or business(es) that individually have total assets of less than $10 million or average annual gross receipts of $10 million or less. In addition, the proposed revenue procedure prescribes that multiple requests to make qualifying same-year method changes may be made in one request.

The Treasury Department and the IRS are requesting comments on all aspects of the proposed revenue procedure and on the specific method change issues identified in Notice 2015-40. For example, comments are requested on procedural issues such as:

- What types of changes in methods of accounting do taxpayers anticipate requesting?
- Do taxpayers anticipate requesting changes in methods of accounting prior to the effective dates of the new standards?
- What changes do taxpayers expect will be requested in the year the taxpayer adopts the new financial standards, and should they be allowed as automatic changes?
- What related accounting method changes do taxpayers anticipate requesting that may appropriately be made on a single Form 3115?
- If multiple changes are requested on a single Form 3115, should the taxpayer report a separate section 481(a) adjustment for each change and should those adjustments be netted and a single spread period applied?
- What alternatives to filing a Form 3115 would reduce the taxpayer's burden of compliance?

Comments must be submitted to the IRS National Office by July 24, 2017.

BDO INSIGHTS

Notice 2017-17 underscores the government's willingness to solicit public feedback to better understand the various implications arising from the forthcoming adoption of the new revenue standards, and whether the new standards are consistent with the existing federal tax rules on the timing of income recognition. Adoption of the new revenue standards may create or increase differences between financial accounting and tax accounting rules, and potentially create complexity for certain industries or transactions. As such, the Treasury Department and the IRS recognize that there is interest in clarifying whether the new standards are permissible methods of accounting that may be used for federal income tax purposes. Furthermore, the IRS recognizes that there is growing interest from taxpayers and tax practitioners for the government to issue guidance on conformity issues as well as revenue procedures to help taxpayers to obtain consent to change accounting methods for income items affected. While the IRS must balance taxpayers' needs to comply with the new standards with its need to approve appropriate method changes, Notice 2017-17 is a positive sign that the government is willing to consider procedures that ease the burden of compliance. Lastly, the Notice is a timely reminder that adoption of the new revenue standards are forthcoming and taxpayers need to begin anticipating the impact of the new standards on their revenue streams and conformity with the Code and regulations.

For additional information, please refer to BDO's Revenue Recognition Resource Center, which includes an in-depth Financial Reporting Letter that summarizes the new standards with examples and practical considerations.

The Accounting Methods group within BDO USA's National Tax Office has extensive experience assisting taxpayers of all industries and sizes with their accounting method issues and filing accounting method change requests with the IRS.

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