

# CHIEF COUNSEL ADVICE AFFIRMS TAXPAYER'S ABILITY TO CORRECT IMPERMISSIBLE INCOME RECOGNITION METHOD VIA AUTOMATIC CHANGE PROCEDURES

## SUMMARY

Effective for tax years beginning on or after December 31, 2017, accrual method taxpayers with applicable financial statements (AFS) may not recognize income for tax purposes later than the tax year in which that income is taken into account as revenue in the taxpayer's AFS. Under Section 451(b) of the Internal Revenue Code, as amended by tax reform, accrual basis taxpayers that are currently deferring income to a tax year later than when books recognize such income are generally required to change their existing method of accounting. In December 2018, the IRS issued Rev. Proc. 2018-60, which enables taxpayers to file a Form 3115, Application for Change in Accounting Method, under the automatic consent change procedures (automatic change #239) to comply with the new requirements.

While Rev. Proc. 2018-60 applies largely to revenue recognition method changes resulting from the new Section 451(b) rule, the language in the revenue procedure is drafted broadly enough to include fact patterns beyond the acceleration of income in accordance with a taxpayer's AFS. Accordingly, accrual basis taxpayers that are presently on improper income recognition methods may be able to use the automatic consent procedures to change to a method that complies with the requirements of Section 451.

## DETAILS

The issuance of Rev. Proc. 2018-60 in December 2018 provided welcome news for taxpayers seeking to change their method of accounting to comply with the new income recognition requirements enacted as part of tax reform. In a brief Chief Counsel Advice (CCA 201852019) published subsequent to the revenue procedure, the IRS confirmed the broad applicability of Rev. Proc. 2018-60 by concluding that an accrual method taxpayer presently on an improper method of accounting could use the automatic change procedures under Rev. Proc. 2018-60 to change its accounting method to comply with Section 451(b)(1)(A). The taxpayer's method, while not described in detail in the CCA, was determined to be impermissible as it did not comply with either the all events test of Section 451, as amended by tax reform, or with Section 451 prior to being amended by tax reform.

In concluding that the taxpayer could use the automatic consent procedures to change to a proper method of accounting under Section 451, the IRS pointed to the applicability language provided in Rev. Proc. 2018-60. Specifically, Rev. Proc. 2018-60 allows an accrual method taxpayer with an AFS to change its method for the recognition of income to a method of accounting that complies with Section 451(b)(1)(A).

Effective for tax years beginning on or after December 31, 2017, accrual method taxpayers with applicable financial statements (AFS) may not recognize income for tax purposes later than the tax year in which that income is taken into account as revenue in the taxpayer's AFS.

Section 451(b)(1)(A) includes the requirements of the all events test under Section 451(b)(1)(C). Accordingly, taxpayers with historical methods of accounting that may not have complied with the all events test (e.g., including an item in income in the year after the income has been earned, due or received) can file an automatic method change under Rev. Proc. 2018-60 to change to a proper method that complies with Section 451(b)(1)(A), assuming the terms and conditions set forth in Rev. Proc. 2018-60 are met.

As many income recognition method changes have historically required advance consent from the IRS, the CCA provides additional relief for taxpayers that want to change to a proper income recognition by allowing them to use the more streamlined automatic consent method change procedures. Note, however, that cash method taxpayers that have been improperly recognizing income under their overall method of accounting (e.g., not including income upon the actual or constructive receipt of cash) are outside the application of this CCA and Rev. Proc. 2018-60. Similarly, taxpayers without an AFS or using a special method of accounting, such as the percentage-of-completion method under Section 460, are excluded from the scope of Rev. Proc. 2018-60 as well. Thus, such taxpayers may still be required to change their method of accounting using the advance consent procedures.

## **CONTACT**

### **Daniel Vukosa**

Senior Manager - Tax Services  
dvukosa@oumcpa.com  
415.796.6549

### **Warren Chung**

Partner - Tax Services  
wchung@oumcpa.com  
415.796.6629

### **Brad Weisert**

Partner - Tax Services  
bweisert@oumcpa.com  
415.796.6640

### **Wendy Weiss**

Partner - Tax Services  
wweiss@oumcpa.com  
415.796.6680



#### **San Francisco-Main Office**

601 California St. 18th Floor  
San Francisco, CA 94108  
415.434.3744

#### **San Diego Office**

1925 Palomar Oaks Way, Suite 210  
Carlsbad, CA 92008  
760.929.5959

Visit our website at [oumcpa.com](http://oumcpa.com)

This document contains general information only and OUM & Co. LLP is not, by means of this document, rendering accounting, business, financial, investment, legal, tax, or other professional advice or services. This document is not a substitute for such professional advice or services, nor should it be used as a basis for any decision or action that may affect your business. Before making any decision or taking any action that may affect your business, you should consult a qualified professional advisor. OUM & Co. LLP shall not be responsible for any loss sustained by any person who relies on this document.

The OUM logo is a trademark of OUM & Co. LLP, Inc. in the United States and other countries. All other trademarks are the property of their respective owners. 3/2019