August 8, 2017

The Honorable John A. Koskinen
Commissioner
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

Re: Comments on Section 6.03 of Rev. Proc. 2017-30, Regarding Sale, Lease or Financing Transactions Method Changes

Dear Commissioner Koskinen:

Enclosed please find comments recommending modifications to section 6.03 of Rev. Proc. 2017-30, regarding automatic method changes for certain sale, lease or financing transactions. These comments are submitted on behalf of the American Bar Association Section of Taxation and have not been approved by the House of Delegates or the Board of Governors of the American Bar Association. Accordingly, they should not be construed as representing the position of the American Bar Association.

The Section of Taxation would be pleased to discuss the Comments with you or your staff if that would be helpful.

Sincerely,

William H. Caudill
Chair, Section of Taxation

Enclosure

cc: William M. Paul, Acting Chief Counsel and Deputy Chief Counsel (Technical), Internal Revenue Service
Scott Dinwiddie, Associate Chief Counsel (Income Tax & Accounting), Internal Revenue Service
Hon. David Kautter, Assistant Secretary (Tax Policy), Department of the Treasury
Dana L. Trier, Deputy Assistant Secretary (Tax Policy), Department of the Treasury
Thomas West, Tax Legislative Counsel, Department of the Treasury
AMERICAN BAR ASSOCIATION
SECTION OF TAXATION

COMMENTS REGARDING SECTION 6.03 OF REV. PROC. 2017-30

The following comments ("Comments") are submitted on behalf of the American Bar Association Section of Taxation ("Section") and have not been approved by the House of Delegates or Board of Governors of the American Bar Association. Accordingly, they should not be construed as representing the position of the American Bar Association.

These Comments were drafted at the invitation of the Office of Associate Chief Counsel (Income Tax & Accounting) and address recommended changes to Rev. Proc. 2017-30 relating to accounting method changes for certain sale, leasing or financing transactions. Principal responsibility for preparing these Comments was exercised by Susan Grais of the Section’s Tax Accounting Committee (the “Committee”). Substantive contributions were made by Les Schneider of the Committee. The Comments were reviewed by David Auclair, Chair of the Committee. The Comments were further reviewed by Colleen O’Connor, of the Section’s Committee on Government Submissions and Past Chair of the Committee; Tom Greenaway, Council Director for the Committee; and Julian Y. Kim, Section Vice Chair (Government Relations).

Although the members of the Section who participated in preparing these Comments have clients or are employed by companies or firms that might be affected by the procedure addressed by these Comments, no such member or company or firm which such member belongs has been engaged by a client to make a government submission with respect to, or otherwise to influence the development or outcome of, the specific subject matter of these Comments.

Contact: David Auclair
(202) 521-1515
david.auclair@us.gt.com

Date: August 8, 2017
Background

Since the issuance of Rev. Proc. 64-16, the first accounting method change revenue procedure, the Internal Revenue Service (the “Service”) has promoted voluntary compliance with respect to accounting methods through a dual approach. Under this dual approach, taxpayers that voluntarily seek to correct an impermissible method of accounting receive certain favorable terms and conditions incident to the accounting method change; whereas taxpayers that fail to voluntarily correct an impermissible method of accounting are likely to receive less favorable terms and conditions from the Service if the accounting method is adjusted during an examination.

One of the most important of the favorable terms and conditions for a taxpayer that voluntarily changes an accounting method is “audit protection.” The concept of audit protection means that the Service agrees not to raise an issue regarding the taxpayer’s prior use of the impermissible method of accounting for any taxable year prior to the year of change to the proper method of accounting. Thus, a taxpayer voluntarily correcting an impermissible method of accounting cannot be required to correct its impermissible method of accounting for any taxable year prior to the effective date of the accounting method change.

The Service provides a “List of Automatic Changes” to which the automatic change procedures in Rev. Proc 2015-13 apply. The most recent issuance of the List of Automatic Changes is contained in Rev. Proc. 2017-30. In general, a taxpayer that voluntarily files a method change under the procedures in Rev. Proc. 2015-13 receives audit protection. There are, however, exceptions to this general rule, and one of these exceptions is when the change in the List of Automatic Changes provides that the change is not subject to audit protection. Of particular note, audit protection is not provided for a taxpayer that voluntarily changes its method of accounting for certain sale, lease or financing transactions under section 6.03 of Rev. Proc. 2017-30.

Section 6.03 of Rev. Proc. 2017-30

Section 6.03 of Rev. Proc. 2017-30 applies to eligible automatic method changes for certain sale, lease or financing transactions. Accounting method changes within the scope of this section include changes from:

(i) improperly treating property as sold by the taxpayer to properly treating property as leased or financed by the taxpayer;

(ii) improperly treating property as leased by the taxpayer to properly treating property as sold or financed by the taxpayer;

---

1 1964-1 C.B. 677.
3 2017-18 I.R.B. 1131.
(iii) improperly treating property as financed by the taxpayer to properly treating property as sold or leased by the taxpayer;

(iv) improperly treating property as purchased by the taxpayer to properly treating property as leased by the taxpayer; and

(v) improperly treating property as leased by the taxpayer to properly treating property as purchased by the taxpayer.

Presently, the change in method of accounting under section 6.03 of Rev. Proc. 2017-30 is made using a cut-off method. Accordingly, a section 481(a)\(^6\) adjustment is neither required nor permitted. When there is a change in method of accounting to which section 481(a) applies, taxable income for the taxable year preceding the year of change must be determined under the method of accounting that was then employed, and taxable income for the year of change and the following taxable years must be determined under the method of accounting for which consent is granted as if that method of accounting had always been used, plus the adjustment amount required under section 481(a).\(^7\) When a change in method of accounting is made on a cut-off basis, only the items arising on or after the beginning of the year of change are accounted for under the method of accounting for which consent is granted. Any items arising before the year of change continue to be accounted for under the taxpayer's former method of accounting.\(^8\)

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, the taxpayer must file Form 3115 (“Application for Change in Accounting Method”) under the non-automatic change procedures of Rev. Proc. 2015-13. Unless unusual and compelling circumstances exist, the Service will not consider a taxpayer’s request to change a method of accounting for a sale, lease, or financing transaction entered into before the beginning of the year of change unless a specific representation, signed under penalties of perjury by the counterparty to the transaction, is provided.\(^9\) In practice, however, it is often impractical or impossible to obtain such representations either because of the number of leases or the unwillingness of any of the counterparties to provide the representation.

As noted above, one of the exceptions to the general rule of providing audit protection to a taxpayer that voluntarily makes a method change is when it is otherwise provided in the description of the change in the List of Automatic Changes. The failure to grant audit protection for the method changes in section 6.03 of Rev. Proc. 2017-30 appears to be connected to the method change being implemented on a cut-off method instead of through a section 481(a) adjustment.\(^10\) However, as discussed below, taxpayers filing automatic accounting method

---

\(^6\) “References to a “section” are to a section of the Internal Revenue Code of 1986, as amended (the “Code”), unless otherwise indicated.”

\(^7\) See section 2.06 of Rev. Proc. 2015-13.


\(^10\) Rev. Proc. 2017-30 also provides that the following method changes made on a cut-off method will not receive audit protection: (1) revocation of section 171(c) election (section 5.01); (2) certain tenant construction allowances (section 6.08); (3) research and experimental expenditures (section 7.01); (4) advance payments, change in
change requests using a cut-off method need audit protection just as much as taxpayers that change their methods of accounting under the non-automatic procedures with a section 481(a) adjustment.

The fact that a cut-off method is prescribed does not necessarily mean that the taxpayer’s prior method of accounting for similar transactions was proper. Thus, filing an accounting method change request under a cut-off method where the taxpayer’s prior method of accounting was improper invites the same amount of audit scrutiny from the Service as those changes made with a section 481(a) adjustment. The audit protection incentive also can impact the financial statement reserves associated with an improper method of accounting because without audit protection, financial statements must take into account possible exposure associated with an improper method.

We submit that many taxpayers may not file an accounting method change request to correct an impermissible method of accounting (regardless of the transition approach) if the taxpayer will not receive audit protection. If a taxpayer files an accounting method change request to correct an impermissible method of accounting, the taxpayer is voluntarily disclosing to the Service the use of an impermissible method of accounting. If audit protection is not granted in these circumstances, a Service examiner could simply use the information in the taxpayer’s accounting method change request to make a taxpayer-unfavorable adjustment in the taxpayer’s earliest open taxable year, including a taxpayer-unfavorable section 481(a) adjustment relating to amounts in prior years. The lack of audit protection in such a situation creates a meaningful disincentive for taxpayers to voluntarily file a request to correct an impermissible method of accounting. We are unaware of any policy reason why the Service would benefit from creating an exception to the general rule for audit protection for these types of accounting method changes.

There also could be a significant increase in the number of taxpayers considering whether to file a method change under section 6.03 of Rev. Proc. 2017-30, as taxpayers implement recently announced changes in financial accounting standards. In 2016, the Financial Accounting Standards Board (“FASB”) issued final guidance on the financial reporting for leasing transactions. This new standard affects all companies and other organizations that lease assets, including but not limited to industries such as retail, real estate, manufacturing, public utilities and transportation. The new standard will impact lessees’ accounting for income taxes. Accounting for leases traditionally has been a complex area, and the new FASB guidance represents a significant change in the presentation for lessees. With new assets and liabilities to be recorded for financial statement balance sheet purposes, taxpayers are beginning the initial assessment of the implications of these new rules for tax purposes.

From a federal tax perspective, accounting method changes are not required as a consequence of the new financial accounting rules because book/tax conformity is not a requirement of a proper tax method for this item. Importantly, however, some entities may discover that their present

---

applicable financial statements (section 16.10); (5) change from mark-to-market under section 475 to realization method with respect to valuation (section 23.02); and, (6) de minimis OID (section 29.01).

methods of classifying and accounting for leases and, for example, payments with respect to leases are not proper tax methods of accounting. As a consequence, we anticipate an increased volume of accounting method changes in this area. Ensuring that there are appropriate incentives (most importantly, audit protection) for these voluntary automatic method changes will encourage compliance and be more consistent with the Service’s long-standing dual approach policy.

Conclusion

For the reasons discussed herein, we respectfully request that the Service modify section 6.03 of Rev. Proc. 2017-30 to provide audit protection for the automatic method changes included within its scope. If you believe it would be helpful, we would welcome the opportunity to meet with the appropriate personnel to discuss these comments.