September 13, 2017

The Honorable John A. Koskinen
Commissioner
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20024

Re: Comments on Notice 2017-17

Dear Commissioner Koskinen:

Enclosed please find comments on Notice 2017-17 concerning the proposed revenue procedure for requesting consent to change a method of accounting in adopting ASC 606 (“Comments”). 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 will be pleased to discuss the Comments with you or your staff if that would be helpful.

Sincerely,

[Signature]

Karen L. Hawkins
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 ON NOTICE 2017-17 CONCERNING THE PROPOSED REVENUE PROCEDURE FOR REQUESTING CONSENT TO CHANGE A METHOD OF ACCOUNTING IN ADOPTING ASC 606

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 the Board of Governors of the American Bar Association. Accordingly, they should not be construed as representing the position of the American Bar Association.

Principal responsibility for preparing these Comments was exercised by Carol Conjura of the Section’s Committee on Tax Accounting (the “Committee”). Substantive contributions were made by Ryan Corcoran, Sharon Kay, Colleen O’Connor, Andrea Mouw and David Strong of the Committee. The Comments were reviewed by David Auclair, Chair of the Committee. The Comments were further reviewed by Ellen McElroy of the Section’s Committee on Government Submissions; Tom Greenaway, Council Director for the Committee; and Julian Y. Kim, 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 procedures 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 influence the development or outcome of, the specific subject matter of these Comments.

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Date: September 13, 2017
Executive Summary

Notice 2017-17 invites comments on a proposed revenue procedure (hereinafter referred to as the “temporary automatic consent procedure”) that when finalized will provide procedures by which a taxpayer may request automatic consent for a limited period of time in connection with the adoption of the new financial accounting standards for revenue recognition (Accounting Standards Codification (“ASC”) 606). The temporary automatic consent procedure would permit a taxpayer to change a method of accounting for tax purposes when the change is made for the same taxable year for which the taxpayer adopts ASC 606 and the change is made as a result of, or directly related to, the adoption of the new revenue recognition standards (i.e., a qualifying same-year method change). Although the new standards change the financial accounting rules for revenue recognition under GAAP, these changes will have a collateral impact on the tax accounting for revenue from customer contracts affected by the new standards. We commend the Internal Revenue Service (the “Service”) for taking steps to address and reduce the potential compliance burdens that taxpayers might otherwise face as a result of changing accounting methods for tax in connection with their adoption of ASC 606.

This letter sets forth several recommendations for improving and clarifying the availability, scope, terms, and consequences of making a change in method of accounting under the temporary automatic consent procedure. Specifically, the Section recommends the following:

1. That the limited time period for making automatic changes under the temporary automatic consent procedure related to the adoption of ASC 606 be expanded to include the tax year immediately prior to and the tax year immediately following the adoption of ASC 606;

2. That the temporary automatic consent procedure be clarified to explicitly allow changes that are made in connection with a review of ASC 606, even if ASC 606 does not ultimately require an accounting change, or provides for a different change to be made, for one or more items of revenue;

3. That the temporary automatic consent procedure be changed to allow taxpayers a choice between making an accounting method change on a cut-off basis or
computing a section 481(a) adjustment,\textsuperscript{3} including for long-term contracts under section 460 and for an advance payment change otherwise subject to the cut-off approach in Revenue Procedure 2017-30;\textsuperscript{4}

4. That the temporary automatic consent procedure explicitly authorize changes in accounting method for revenue from long-term contracts, as well as concomitant changes in the timing of deductions (e.g., section 461, section 263A, or section 471) that may be necessitated by either the change made under section 451 or section 460, or other guidance, or exclusively as a result of the adoption of ASC 606;

5. That if a taxpayer complies with the temporary automatic consent procedure, and later the IRS on exam challenges the permissibility of the new method, then Exam should be able to correct the new method starting with the year of change, and the taxpayer should be entitled to audit protection for prior years;

6. That taxpayers making a change under the temporary automatic consent procedure should be able to seek a private letter ruling under Revenue Procedure 2017-1\textsuperscript{5} (or an applicable successor) to determine whether their proposed method of accounting is a permissible method under the applicable provisions of the Code, regulations, and other guidance; and

7. That the exception for small businesses provided in the proposed temporary automatic consent procedure be expanded to provide that taxpayers with trades or businesses satisfying the definition of a small business be allowed to make accounting method changes under this procedure without filing a Form 3115, and that the definition of a “small business” be expanded to include trades or businesses with total assets or average annual gross receipts of $20 million or less.

Background

On May 28, 2014, the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) jointly announced new financial accounting standards for recognizing revenue, titled “Revenue from Contracts with Customers.”\textsuperscript{6}

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

\textsuperscript{3} References to a “section” are to a section of the Internal Revenue Code of 1986, as amended (the “Code”), unless otherwise indicated.
\textsuperscript{4} 2017-18 I.R.B. 1131.
\textsuperscript{5} 2017-1 I.R.B. 1.
reporting periods beginning after December 15, 2018. Early adoption is allowed for reporting periods beginning after December 15, 2016.\(^7\)

On June 15, 2015, the Department of Treasury ("Treasury") and the Service published Notice 2015-40,\(^8\) 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 Service consent to change a method of accounting are adequate to accommodate those requests.

Notice 2017-17 sets forth the procedures for obtaining Service consent for a qualifying same-year method change and provides the text of a proposed revenue procedure that would allow taxpayers making certain types of changes in method of accounting for revenue to be eligible for the automatic consent procedures currently set forth in Revenue Procedure 2015-13\(^9\) on a temporary basis in connection with their adoption of ASC 606.

Qualifying same-year method changes may include automatic changes for which existing guidance, including Revenue Procedure 2015-13 and Revenue Procedure 2017-30, already provides automatic change procedures. Taxpayers requesting consent for automatic changes for which existing guidance already provides automatic change procedures must use the existing automatic change procedures to make a request. For qualifying same-year method changes for which existing guidance does not provide automatic change procedures but which comply with section 451 or other guidance regarding the taxable year of inclusion of income, the taxpayer must make the change under the proposed revenue procedure (\textit{i.e.}, the temporary automatic consent procedure).

In addition to setting forth the text of the proposed revenue procedure, Treasury and the Service requested comments on all aspects of the proposed procedures. Comments are specifically requested on the following issues:

1. Is the exception for small businesses in paragraph 5.02(2) of the proposed revenue procedure appropriate?

2. What types of changes in methods of accounting do taxpayers anticipate requesting?

3. Do taxpayers anticipate requesting changes in methods of accounting prior to the effective dates of the new standards?

4. Which procedures should taxpayers be required to use to request permission for a qualifying same-year method change – the automatic accounting method change procedures or the advance consent procedures?

\(^7\) See FASB Update No. 2015-14, "Revenue from Contracts with Customers (Topic 606), Deferral of the Effective Date."
\(^8\) 2015-24 I.R.B. 1057.
\(^9\) 2015-1 I.R.B. 419.
5. What changes, other than those described in Section 5 of the proposed revenue procedure, do taxpayers expect will be requested in the year the taxpayer adopts the new financial standards, and should they be allowed as automatic changes?

6. What related accounting method changes do taxpayers anticipate requesting that may appropriately be made on a single Form 3115?

7. If multiple changes are requested on a single Form 3115, should the taxpayer report a separate section 481 adjustment for each change, and should those adjustments be netted and a single spread period applied?

8. What alternatives to filing a Form 3115 would reduce the burden of compliance?

9. What transition procedures may be helpful?

10. What additional procedural changes would be appropriate and helpful?

Specific Recommendations

Limited Period of Availability

Recommendation: The Section recommends that the limited time period for making automatic changes under the temporary automatic consent procedure related to the adoption of ASC 606 be expanded to include the tax year immediately prior to and the tax year immediately following the adoption of ASC 606.

Discussion: The temporary automatic consent procedure would permit changes under section 451 (other than changes subject to a pre-existing automatic consent procedure) to be made automatically for the “same year” the taxpayer adopts ASC 606. Presently, there are very few accounting method changes involving the timing of income under the all-events test of section 451 that may be made automatically. In contrast, Revenue Procedure 2017-30 authorizes more than 200 automatic accounting method changes for items ranging from the timing of expenses, inventory methods, depreciation and capitalization of costs, and not one of these changes is temporary in nature. Treasury and the Service also have a long history of permitting automatic accounting method changes in connection with the issuance of new guidance on accounting methods, including changes addressing both specific, narrowly applicable guidance as well as guidance of a general nature, such as the tangible property regulations. In most instances, the ability to make an automatic change does not expire.

It is not clear why Treasury and the Service have provided automatic consent for so few accounting method changes under section 451. It is our understanding that most automatic accounting method changes were designated automatic either because of the issuance of new guidance or because the Service’s National Office received a high volume of requests that are viewed as routine. However, the issuance of new guidance as well as the routine nature of particular changes does not appear to have been critical in
the Service’s decision to make many accounting method changes available automatically. For example, Revenue Procedure 2017-30 permits changes to the tangible property regulations to be made automatically even after the transition period; changes involving inventory methods are also permitted automatically even when the change involves different methods and even different submethods. The Service’s decision to permit these automatic changes appears to be based on balancing the need for Service review of proposed accounting methods prior to granting consent with the need to conserve limited Service resources and to prevent an administrative backlog in the advance consent process.

Because ASC 606 applies to most businesses with respect to one or more of their sources of revenue, its issuance has compelled a comprehensive review of accounting methods for revenue recognition for both financial reporting and tax purposes. Businesses implementing the new standards for the first mandatory effective date in 2018 necessarily began reviewing revenue recognition policies well before the 2018 deadline. In that process, businesses may have discovered that it is either desirable or necessary to change one or more of their accounting methods for revenue recognition for tax purposes under the all-events test. Similarly, in the process of implementing ASC 606, it is reasonable to expect that some businesses may determine that the tax impacts of the new standards need to be changed during the period following the first effective year. While it is expected that the majority of tax accounting method changes will be filed in the first effective year (2018 or 2019, as applicable), having a three-year window in which to make these changes automatically will minimize compliance burdens for both taxpayers and the Service. Providing an expanded window should not compromise sound tax administration given that the temporary automatic consent procedure provides bare consent to make the necessary changes in accounting methods without any ruling protecting the new method as a permissible method of accounting. More importantly, expanding the time for these automatic changes also would enable the Service to review more income changes and potentially gather the information necessary to expand the number of revenue recognition accounting method changes that are available automatically on a more permanent basis.

Circumstances of Availability Clarified and Specified

Recommendation: The Section recommends that the temporary automatic consent procedure be clarified to allow changes that are made in connection with a review of ASC 606, even if ASC 606 does not require an accounting change, or provides for a different change to be made, for one or more items of revenue.

Discussion: The temporary consent procedure would apply to a change in accounting method that is made “as a result of, or directly related to, the adoption” of the new standard. However, the adoption of ASC 606 is a catalyst for a comprehensive review of a company’s revenue recognition, which may result in the need for a tax accounting method change even if no corresponding change is made for financial reporting purposes in connection with the adoption of ASC 606. Due to the significant variations in the timing of revenue recognition under ASC 606 and federal income tax principles, a change in revenue recognition under GAAP does not necessarily mean that the same change must be made for tax purposes. In some cases, as a result of evaluating ASC 606 and its
tax implications, a company may determine that the present accounting method used for tax purposes is a proper method, but that an alternative permissible method is preferred. That alternative method may or may not be consistent with the new financial reporting method. Alternatively, and whether or not there is a change in financial reporting for a particular revenue stream, a company may determine that the present revenue recognition method used for tax purposes is an impermissible tax method of accounting and, therefore, the company must make an accounting method change for tax purposes.

For these reasons, we recommend that the Service view a company’s adoption of ASC 606 as an opportunity to enhance voluntary compliance with accounting method provisions. The Service has a longstanding practice of encouraging voluntary compliance for accounting methods recognizing that voluntary compliance allows Examining Agents to focus on more compelling compliance initiatives. Accordingly, we recommend that the Service explicitly provide that a taxpayer may change its accounting methods for revenue recognition under the temporary automatic consent procedure as long as the accounting method change is identified in connection with assessing the application of ASC 606, without regard to whether a change in accounting method is made explicitly in connection with an item of revenue in adopting the new standard.

Choice of Section 481(a) Adjustment or Cut-Off

Recommendation: The Section recommends that accounting method changes made under the temporary automatic consent procedure allow taxpayers a choice between implementing with a section 481(a) adjustment or making the change on a cut-off basis. The Section requests that this elective provision be available, in particular, for accounting method changes for long-term contracts under section 460 and advance payment changes otherwise subject to the cut-off approach in Revenue Procedure 2017-30 (i.e., Section 16.10 Advance payments – change in applicable financial statements).

Discussion:

Section 481(a) requires a taxpayer to make any adjustments necessary to avoid duplicating or omitting amounts from income by reason of an accounting method change. Under section 481(c), however, a section 481(a) adjustment may be taken into account and subject to conditions prescribed by the Service. Regulation section 1.446-1(e)(3)(ii) provides that administrative procedures prescribe the terms and conditions necessary to secure the Commissioner’s consent to effect an accounting method change and to prevent amounts from being duplicated or omitted. Such terms and conditions may require that the change be effected on a cut-off basis or by an adjustment under section 481(a) to be taken into account in the taxable year or years prescribed by the Commissioner. Therefore, Treasury and the Service have the authority to give taxpayers a choice of implementing an accounting method change with a section 481(a) adjustment or on a cut-off basis. The Section believes that allowing taxpayers a choice to implement these accounting method changes with a section 481(a) adjustment or on a cut-off method will incentivize greater accounting method compliance and will avoid the possibly inequitable results that will occur if a single transition method is prescribed.

As noted previously, many taxpayers currently follow their GAAP method of recognizing revenue, regardless of whether the GAAP method is permissible for federal income tax
purposes. The adoption of ASC 606 is an impetus for a review of a company’s federal income tax accounting methods for revenue. As part of this process, a company may determine that the present revenue recognition method used for tax purposes is an impermissible tax method of accounting even if no change is required by ASC 606. However, certain GAAP changes may cause taxpayers to be in a significantly worse tax position, depending on the various transition methods (both GAAP and tax).

Under the new GAAP standard, taxpayers are allowed a choice of implementation approaches: the full retrospective approach and the modified retrospective approach. Under the full retrospective approach, a taxpayer determines the cumulative effect of applying the new standards as of the beginning of the first historical period presented, and recomputes revenue and expenses for all prior periods presented in the year of adoption of the new standards. Generally, for a taxpayer implementing on January 1, 2018, the taxpayer must include the cumulative effect through December 31, 2015, as an adjustment to retained earnings and revise its revenue and expenses reported for 2016, 2017 and 2018 (and going forward) to apply the new standard. Under the modified retrospective approach, a taxpayer implementing on January 1, 2018, applies the new standards to all new contracts initiated on/after the effective date, and makes a cumulative adjustment through December 31, 2017, to the opening balance of retained earnings. Prior periods are not restated.

The implementation of ASC 606 and the resulting accounting method changes that are required are complex compared to other widespread accounting method changes. For example, when companies were required to make various accounting method changes to comply with the final tangible property regulations, it was possible to estimate the scope of, and thus the burden of, implementation. Here, taxpayers are facing a bigger impact, both with respect to the number of changes and the costs of implementation.

If a section 481(a) adjustment is required for all accounting method changes initiated as a result of ASC 606 (other than those for which the cutoff method presently applies, which we presume would continue), some taxpayers will face undue burden – e.g., taxpayers with different book and tax methods that must track each customer contract separately for tax purposes will face costly and time-consuming calculations.

Additionally, the requirement to solely use a cut-off method for certain changes such as section 460 historically has caused added burden to taxpayers rather than providing relief. Traditionally, accounting method changes for long-term contracts under section 460 are made on a cut-off basis, which is consistent with the final regulations under section 460 but inconsistent with proposed regulations from 2008. For many companies, the requirement to apply a cut-off method for long-term contracts presents a significant administrative challenge because it requires the continued use of the old method for contracts that overlap with new contracts. As a result, the cut-off method requires taxpayers to maintain two sets of books in addition to the records that are required for financial reporting purposes under ASC 606. Therefore, many taxpayers would prefer to implement both the new ASC 606 method and the fully recomputed section 460 method at the same time to avoid the extra burden of dual tax computations going forward.

The existing cut-off procedures in Revenue Procedure 2017-30 for certain deferred revenue method changes that arise from a change in book treatment are another source of
concern. As drafted, the temporary automatic consent procedure provides that if a particular type of accounting method change is already subject to an automatic consent procedure, the taxpayer must use that procedure to make a change in connection with ASC 606 instead of the temporary automatic consent procedure. This requirement will cause an unusual hardship because many accounting method changes will be required for advance payments.

Revenue Procedure 2004-34 permits taxpayers that receive advance payments for services, goods, and certain other items to use a limited deferral method whereby the advance payments generally may be deferred for tax purposes for a one-year period provided that the advance payment is reported in the applicable financial statement in a year subsequent to the year of receipt. Pursuant to Revenue Procedure 2017-30, if there is a change in the time when the financial statements recognize some or all of the advance payments, taxpayers are required to treat that as a change in accounting method for tax purposes even though the taxpayer is already using the deferral method and has to adjust the amount reported in the year of receipt. However, Revenue Procedure 2017-30 provides alternative procedures for this type of accounting method change and requires the change to be implemented on a cut-off basis.

Many taxpayers that receive advance payments under customer contracts will be required to change the time when those advance payments are recognized as a result of ASC 606. Because of the financial statement conformity requirement inherent in the deferral method permitted by Revenue Procedure 2004-34, those taxpayers will be compelled to make a correlative change to adjust the time when advance payments are recognized for tax purposes. In many cases, the adoption of ASC 606 is expected to result in the acceleration of advance payments into an earlier period. By forcing taxpayers to use the cut-off procedure in Revenue Procedure 2017-30, taxpayers in this situation would have to recognize double the amount of revenue from advance payments in the initial transition year than if they were permitted to take a section 481(a) adjustment into account, which would spread the cumulative adjustment over a four-year period beginning with the year of change. The application of the cut-off method in this circumstance seems to be unnecessarily punitive because the accounting method change is necessitated by the adoption of ASC 606.

ASC 606 may involve more than just advance payments and so the advance payment change may be accompanied by a number of other changes under section 451 – all of them with a section 481(a) adjustment. It is difficult to appreciate the policy objective served by singling out this change and not allowing the option of a section 481(a) adjustment.

Therefore, the Section recommends that Treasury and the Service exercise their discretion and permit taxpayers to have a choice between making adjustments either in accordance with section 481(a) or on a cut-off basis.

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10 2004-1 C.B. 991.
Scope of Permitted Automatic Changes

Recommendation: The Section recommends that the temporary automatic consent procedure explicitly authorize changes in accounting method for revenue from long-term contracts, as well as concomitant changes in the timing of deductions (e.g., section 461, section 263A, or section 471) that may be necessitated by either the change made under section 451, section 460, or other guidance, or exclusively as a result of the adoption of ASC 606.

Discussion: The temporary automatic consent procedure generally describes its scope to include a change in method of accounting “which complies with section 451 of the Code or other guidance….” It is not clear whether the reference to other guidance is intended to include only other guidance with respect to revenue subject to section 451 (such as the regulations, rulings, and case law) or whether it is intended to encompass guidance under any provision of the Code that concerns the timing of revenue. It also is not clear whether the reference is intended to include accounting method changes for expenses whose timing also may have to be changed as a result of adopting ASC 606 or because of tax-only changes in the timing of revenue under section 451 or section 460.

For example, it is anticipated that many sources of revenue from customer contracts involve long-term contracts subject to the accounting rules of section 460. Because the percentage of completion method involves the timing of both revenue and expenses from long-term contracts, it would be inappropriate to limit the temporary automatic consent procedure strictly to revenue in this context and other similar contexts. If, in the context of evaluating the tax impact of ASC 606, a taxpayer with inventories determines that it has improperly applied the accrual method to certain items that are manufactured, but should have applied the percentage of completion method, or vice versa, the taxpayer will need to change the timing of both revenue and expenses allocable to the contract because it would no longer be permitted to maintain an inventory for items partially complete or not shipped to the customer.

A company also may discover revenue recognition timing differences between book and tax upon shipment (e.g., revenue-in-transit, synthetic FOB destination, bill-and-hold arrangements, etc.) and identify a need to change its tax method of accounting to recognize revenue under section 451 and expense recognition under section 461 (including cost of goods sold). If, during the assessment and implementation of ASC 606, a taxpayer identifies these changes, it will need to change the timing of revenue, the related cost of sales, and the costs required to be capitalized under section 263A (if applicable).

For example, a taxpayer ships goods with stated FOB shipment terms. However, as a matter of customer satisfaction and retention, the taxpayer will replace or refund the cost of any items lost or damaged during shipment. This arrangement could create synthetic FOB destination terms for the purposes of financial statement accounting. The taxpayer will delay the recognition of revenue and related expense until the estimated time in transit is complete. If, during the assessment of its sources of revenue and related contracts, the taxpayer identifies an improper application of the accrual method with
respect to this or similar types of transactions, the taxpayer may need to separately change the timing of the revenue and the expenses related to the contract.

Audit Protection Available if New Method Challenged on Exam

Recommendation: The Section recommends that if a taxpayer complies with the temporary automatic consent procedure, and subsequently Exam challenges the permissibility of the new accounting method, then Exam may only correct the new method beginning with the year of change, and the taxpayer should be entitled to audit protection for prior years.

Discussion: For most accounting method changes that are designated for automatic consent in Revenue Procedure 2017-30, there is a body of detailed guidance for taxpayers to refer to and rely on to be assured that their facts are eligible for the automatic consent procedure and that they are applying the new method subject to automatic consent appropriately. In contrast, the application of the all-events test to revenue is highly factual and subjective in many instances, even apart from the potential interaction with ASC 606. Unless and until substantive guidance is issued indicating which aspects of ASC 606, if any, will be respected for federal income tax purposes (such as the allocation of the contract price to different performance obligations and the treatment of variable consideration), the introduction of ASC 606 adds another layer of uncertainty. A taxpayer that implements a change in accounting method under the temporary automatic consent procedure does not obtain certainty that its new method of accounting is a permissible method.

Given the greater likelihood for a change in accounting method made under the temporary automatic consent procedures to be questioned, we believe it would be appropriate for the Service to explicitly provide that a taxpayer making a change in method of accounting under the procedure will be entitled to the audit protection referenced in Revenue Procedure 2015-13 for years prior to the year of change, even if the Exam were to determine that the new method is not a permissible accounting method. As such, the examining agent’s only recourse would be to make corrections to the new method of accounting, and the examining agent would not be permitted to invalidate the change on a retroactive basis.

Availability of Private Letter Ruling Process

Recommendation: The Section recommends that taxpayers making a change under the temporary automatic consent procedure should be able to seek a private letter ruling under Revenue Procedure 2017-1 (or an applicable successor) to determine whether their proposed method of accounting is a permissible method under the applicable provisions of the Code, regulations, and other guidance.

Discussion: In recent years, the Service has had an informal policy of declining to consider private letter ruling requests regarding the permissibility of an existing tax accounting method or the permissibility of a proposed method being changed in the context of an automatic consent procedure. However, for the same reasons discussed above in support of ensuring that taxpayers changing under the temporary automatic consent procedure receive audit protection, taxpayers should be able to obtain a private
letter ruling to address whether the taxpayer’s proposed method is a permissible method of accounting for tax purposes.

Small Business Exception

Recommendation: The Section recommends that the exception for small businesses in the proposed temporary automatic consent procedure be expanded to provide that taxpayers with trades or businesses satisfying the definition of a small business be allowed to make accounting method changes under the temporary automatic consent procedure without filing a Form 3115, and that the definition of a “small business” be expanded to include trades or businesses with total assets or average annual gross receipts of $20 million or less.

Discussion: The temporary automatic consent procedure would allow taxpayers with 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 to make accounting method changes under the procedure for each trade or business on a cut-off basis without a section 481(a) adjustment. While this proposal would alleviate the requirement for taxpayers to retroactively apply the new revenue recognition guidance to compute a section 481(a) adjustment, taxpayers are still obligated to comply with the remaining procedural rules for implementing an accounting method change as outlined under Revenue Procedure 2015-13, including the requirement to complete and file Form 3115. Filing a Form 3115 can be a significant burden for small taxpayers due to their limited tax and accounting personnel resources who may also be burdened with the responsibility of navigating the financial accounting implications of the new guidance. Additionally, many of these taxpayers have limited experience in preparing and filing accounting method changes which can make filing a Form 3115 a daunting task.

Although filing a Form 3115 is a requirement for most accounting method changes, the Service currently recognizes a number of exceptions to this rule and allows taxpayers to make a number of accounting method changes without filing a fully completed Form 3115. For example, in Revenue Procedure 2015-20, the Service permitted small business taxpayers to make certain accounting method changes related to the tangible property regulations without filing a Form 3115 and without taking into account a retroactive section 481(a) adjustment. Similarly, many automatic accounting method changes under Revenue Procedure 2017-30 allow small taxpayers, and in some cases all taxpayers, to request an accounting method change by filing a short Form 3115 (see, e.g., sections 6.01, 11.07, 15.10, 18.01 of Revenue Procedure 2017-30). In other cases, the Service accepts statements in lieu of Form 3115 for taxpayers changing certain methods of accounting (see, e.g., sections 15.04, 16.10 of Revenue Procedure 2017-30). Significantly, the Service accepts a statement in lieu of Form 3115 for the accounting method change required for taxpayers using the deferral method for recognizing advance payments under Revenue Procedure 2004-34 that have changed their method of recognizing these payments in their applicable financial statements.

The purposes of filing Form 3115 include notifying the Service of the taxpayer’s method change as well as disclosing information sufficient to indicate whether the taxpayer’s

proposed method change is permitted. However, these goals should be weighed against the administrative burdens on taxpayers and the Service that arise from the obligation to file Form 3115. In Revenue Procedure 2015-20, the Service specifically noted that easing the administrative burden on small taxpayers was one of the reasons for providing the simplified accounting method change procedures. Small taxpayers are facing a similar administrative burden related to the accounting method changes arising from the revenue recognition guidance, and we believe they should receive similar consideration in this situation.

The gross receipts and total assets thresholds used in the temporary automatic consent procedure to identify “small taxpayers” no longer reflect small businesses in 2017. The $10 million gross receipts threshold is used in a number of different contexts in the Code to identify “small taxpayers” for purposes of qualifying for certain exemptions. For example, small contractors exempt from the long-term contract rules under section 460 are defined as contractors with average annual gross receipts of less than $10 million. The small reseller exception from the uniform capitalization rules under section 263A applies to taxpayers with $10 million or less of gross receipts. Both of these thresholds were enacted in 1986 and have not been adjusted or indexed for inflation. If these limits had been adjusted for inflation, the thresholds would be more than $20 million in 2017.\footnote{\textsuperscript{12} The January 1986 $10 million threshold inflation adjusted to 2017 is $20,329,653 according to the Bureau of Labor and Statistics CPI Inflation Calculator, at http://www.bls.gov/data/inflation_calculator.htm.}

Additionally, several recent budget and tax reform proposals have suggested a higher threshold for identifying small taxpayers. President Obama’s Fiscal Year 2017 budget proposals included a proposed uniform threshold for defining small businesses as businesses with less than $25 million in gross receipts. The Investment in New Ventures and Economic Success Today (INVEST) Act recently proposed by John Thune, a member of the Senate Finance Committee, proposed raising the small business threshold to $15 million in gross receipts. These proposals further indicate that the definition of a small taxpayer has changed since 1986, and the $10 million gross receipts threshold no longer accurately reflects the size of a small business in 2017.