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Tax Accounting Perspectives

ASC 740 Implications of Accounting Method Changes: Year-end considerations

December 14, 2017

As a part of year-end tax planning, calendar year companies may be re-evaluating current tax accounting methods utilized by their domestic and foreign subsidiaries. As part of this analysis, companies should consider when the impact of these changes should be reported within the financial statements.

What's new?

Opportunities through tax accounting method changes

A change in a tax accounting method is a mechanism available to taxpayers to correct improper tax accounting conventions or optimize tax benefits. A tax accounting method refers to the overall method of accounting of an entity (e.g., cash, accrual), as well as the methods of accounting for specific items (e.g., inventory, prepaid expenses, accrued bonuses).

Recently issued Accounting Standard Updates (ASUs), including those related to Revenue Recognition and Lease Accounting, may require changes to book methods of accounting. As a result, companies should consider whether changes to existing tax accounting methods may be warranted.

Highlights

ASC 740 Implications – Method Changes

A taxpayer can file Form 3115 with the IRS to change a tax method of accounting. A change in a tax accounting method will include the computation of an adjustment to prevent taxable income or deductions from being omitted or duplicated. If this adjustment is favorable (i.e., decreases taxable income), the entire amount is included in the taxpayer's income in the tax year for which the method change is effective. If the adjustment is unfavorable (i.e., increases income), the amount is generally recognized ratably in taxable income over four tax years.

The timing of recognition in the financial statement depends on whether the change is from an impermissible or permissible method, and whether the change is eligible for automatic consent under Rev. Proc. 2017-30.

What's new
Opportunities through tax accounting method changes

Highlights
ASC 740 implications of method changes

What does this mean for you
- Manual accounting method changes require action prior to end of tax year
- Potential adjustments recorded in financials

Deloitte perspective
Year-end planning should start now

What does this mean for you

Manual accounting method changes require action prior to the end of the tax year

Accounting methods that are not eligible for automatic consent under Rev. Proc. 2017-30 must be filed with the IRS national office on or before the last day of the tax year in question. These "manual" method changes are considered by the IRS National Office and are granted in the form of affirmative written consent.

Potential adjustments recorded in financial statements

Impermissible to permissible method

An entity using an impermissible income tax accounting method should first assess its tax position to determine whether it results in an uncertain tax position for which an UTB, interest and penalties should be recorded under ASC 740-10.

When an entity files Form 3115 for a change from an impermissible method and obtains consent from the IRS (either automatic or written), it receives "audit protection" for prior tax years, which provides relief from interest and penalties. As such, the reversal of UTBs, interest and penalties from an impermissible method should be recognized when audit protection is received.

Manual Change: Generally, the impact of a non-automatic change from an impermissible method should be recognized when the entity has filed the method change and has received affirmative written consent from the IRS. However, if the consent is considered perfunctory and the entity has met all of the requirements of the change, the impact may be reflected when the entity has concluded it is qualified and has filed Form 3115. Consultation with tax and accounting advisers is encouraged in these situations.

Automatic Change: If an entity meets all of the requirements to make an automatic method change from an impermissible method, IRS consent is deemed to be received and the impact should be recorded when the entity has filed Form 3115. Automatic changes must be filed with the taxpayer's timely filed original income tax return, including extensions.

Permissible to permissible method

Manual Change: The impact of a non-automatic change should be recognized when the entity has filed the method change and received written consent from the IRS. However, if the consent is considered perfunctory and the entity has met all of the requirements of the change, the impact should be recorded when the entity has concluded it is qualified and has the intent and ability to file Form 3115, but no earlier than the first interim period of the year in which the form will be filed.

Automatic Change: If an entity meets all of the requirements to make an automatic method change from a permissible method, the impact should be recorded when the entity has concluded it is qualified and has the intent and ability to file Form 3115.

Refer to the 2016 Deloitte Roadmap to Accounting for Income Taxes, Sections 3.50 and 3.51 for further discussion on accounting for tax method changes.

Deloitte perspective

Year-end planning should start now

It is best practice to evaluate current tax accounting methods on a regular basis to confirm the appropriateness of the methodologies used. Given the potential for tax reform, as well as recent ASUs for revenue recognition and lease accounting, companies may want to take a closer look at the accounting methods of their domestic and foreign subsidiaries. Companies should consider the timing to record the impact of any accounting method change within their financial statements.

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