

Regulatory Actions / Issues

- OMB review – is it slowing guidance or not?
 - Four to six weeks on average for reviews
- Effective dates – 7805(b)
 - (1) Retro only to period ending after Prop. Reg was been filed (BEAT)
 - (2) Retro if filed within 18 months of DOE (GILTI)
- March 5 Policy Statement limiting Notices and Temp. Regs
- Current regulation issues / Reg. plan

Specific Audit Issue:

Income Tax Accounting

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Specific Audit Issue: Income Tax Accounting

Agenda:

- What is “income tax accounting”?
- How are accounting methods adopted?
- What is a change in method of accounting?
- What authority does the IRS have to change a taxpayer’s accounting method?
 - What is Examination’s authority?
 - What is Appeals’ authority?
- What are some strategic considerations to resolve change in method issues?

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Specific Audit Issue: Income Tax Accounting

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“The word ‘audit’ comes from ‘auditory’ which means ‘to hear bad news coming’.”

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Specific Audit Issue: Income Tax Accounting

What is “income tax accounting”?

- Tax accounting rules determine when a taxpayer takes into account an item of income or deduction.
 - Overall cash or accrual method of accounting.
 - Special methods of accounting for specific items (e.g., advance payments).
- It is not “accounting for income taxes.”
- It is not “bookkeeping.”

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Specific Audit Issue: Income Tax Accounting

How are accounting methods adopted?

- A taxpayer adopts a proper accounting method by using it on the first tax return that includes the method.
- A taxpayer adopts (or changes to) an improper accounting method by using it on two consecutive returns.

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Specific Audit Issue: Income Tax Accounting

What is a change in method of accounting?

- A change in method of accounting includes a change in the overall method of accounting or a change in treatment of a material item.
 - What is the item?
- The correction of an error is not a change in method of accounting, and does not require the consent of the Commissioner.
- A change in facts is not a change in method of accounting; the taxpayer simply applies the new facts to its existing method

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Specific Audit Issue: Income Tax Accounting

What authority does the IRS have to change a taxpayer's accounting method?

- The IRS can change a taxpayer's accounting method if, but only if, it does not clearly reflect income.
 - The IRS cannot change a taxpayer from one proper method to another proper method.
 - Is an accounting method improper simply because the taxpayer changed to it without consent?
- Once the IRS determines the taxpayer's accounting method does not clearly reflect income, the IRS can change a taxpayer to any accounting method that, in the IRS's opinion, does clearly reflect income.
 - Can the IRS can change the taxpayer to a method that the taxpayer could not have adopted?
 - What if the IRS changes the method for the year in which the taxpayer adopted the method?

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Specific Audit Issue: Income Tax Accounting



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Specific Audit Issue: Income Tax Accounting

What is Examination's authority?

- If it determines a taxpayer's accounting method is improper, Examination:
 - Must change the taxpayer to a proper accounting method.
 - In the case of a prior improper change, change the taxpayer to its prior method.
 - Must change the taxpayer in the earliest year under examination (if possible).
 - Must impose a § 481(a) adjustment in the year of change (if possible).

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Specific Audit Issue: Income Tax Accounting

What is Appeal's authority?

- Appeals has much greater authority than Examination.
- Appeals may change the taxpayer's accounting method.
- Appeals may resolve the issue without changing the taxpayer's accounting method.
 - Alternative-Timing Resolution.
 - Time-Value-of-Money Resolution.
 - Any other appropriate resolution.

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Specific Audit Issue: Income Tax Accounting

What is Appeal's authority?

- If it changes the taxpayer's accounting method, Appeals:
 - Must change the taxpayer to a proper accounting method.
 - May defer the year of change.
 - Ordinarily not later than the most recent year under examination.
 - In no case, not later than the current taxable year.
 - May impose a § 481(a) adjustment or use a cut-off method.
 - May compromise the amount of the § 481(a) adjustment.
 - May spread the § 481(a) adjustment over any number of years.

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Specific Audit Issue: Income Tax Accounting

What is Appeal's authority?

- Alternative-Timing Resolution:
 - In lieu of changing taxpayer's accounting method.
 - Can apply to all of some of the items arising during, or prior to and during, the years before Appeals.
 - Does not affect any items not covered by the resolution.

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Specific Audit Issue: Income Tax Accounting

What is Appeal's authority?

- Time-Value-of-Money Resolution:
 - In lieu of changing taxpayer's accounting method.
 - Taxpayer pays amount that reflects the time-value-of-money benefit taxpayer received by using its method compared to method preferred by the IRS.
 - Amount can be reduced to reflect hazards of litigation.
 - Amount is not deductible, but the computation can be tax affected to approximate a deduction.
 - IRS provides a sample computation.

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Specific Audit Issue: Income Tax Accounting

What is Appeal's authority?

- If Appeals resolves the issue on a non-accounting-method-change basis:
 - A closing agreement is required.
 - The taxpayer is required to file amended returns to make adjustments to affected subsequent years.
 - The taxpayer must continue to use its current accounting method, unless the taxpayer receives consent to change it.
 - If the IRS imposes an accounting method change in a subsequent year, the § 481(a) adjustment is computed such that there is no duplicate adjustment.

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Specific Audit Issue: Income Tax Accounting

What are some strategic considerations to resolve change in method issues?

- While appeals has the authority to resolve accounting method issues using alternative resolutions, many appeals officers are reluctant to do so because they are unfamiliar with them, so persistence and patience are necessary.
- Alternative resolutions are often optimal because, if the IRS changes your method, you will need the consent of the IRS to change from that new, less favorable method.
 - Example: you are using a favorable method for an item. Another taxpayer is litigating the propriety of that method. IRS Examination proposes changing you from that method. It is optimal to resolve the issue using an alternative resolution because, if the other taxpayer later wins its case, the IRS likely will not consent to your request to change back to the favorable method.

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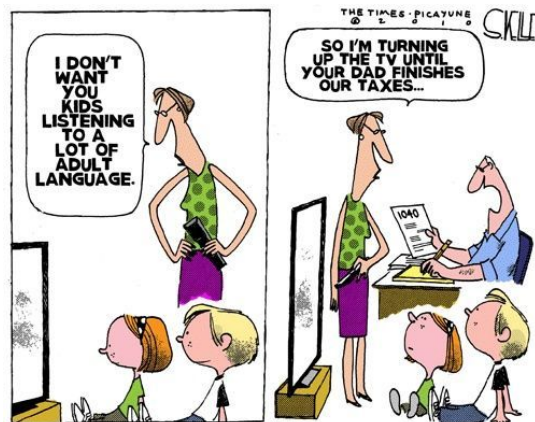
Specific Audit Issue: Income Tax Accounting

What are some strategic considerations to resolve change in method issues?

- Because Examination has limited authority to resolve accounting method issues, it may be necessary to go to Appeals to achieve an optimal resolution.
 - If you must resolve an accounting method issue at Examination, press factual issues because Examination has the discretion to determine facts.
 - Example: Examination proposes changing your inventory method to include numerous additional costs in inventory. Examination has authority to negotiate a resolution to not include some of the costs in inventory because Examination has discretion to determine which costs are incurred by reason of the production of inventory, a factual question.

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Specific Audit Issue: Income Tax Accounting



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