Implications of Tax Reform on Income Recognition

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New Rules for Taxable Year of Inclusion

– The Tax Cuts and Jobs Act (TCJA) modifies the All Events Test to require income recognition under new Section 451(b) no later than when such item is taken into account as revenue for financial accounting purposes

– Does not change income realization but only changes the timing of income recognition

– Exceptions
  • Taxpayers without applicable financial statements
  • Income in connection with mortgage servicing contracts
  • Taxpayers using “special methods of accounting”

– Added complication with concurrent implementation of ASC 606 (new financial accounting standard for revenue recognition)

– Guidance is imminent, but to what extent?
New Rules for Taxable Year of Inclusion

— Section 451(c) codifies the Deferral Method under Rev. Proc. 2004-34, which allows taxpayers to elect one-year income deferral for advance payments for goods and services if such income is also deferred for financial statement purposes

— Excluded from definition of advance payments:
  • Rent
  • Insurance premiums
  • Payments with respect to financial instruments
  • Payments with respect to warranty or guarantee contracts when a third party is the primary obligor

— Similar to the new Section 451(b), implications of ASC 606 implementation may affect election to seek deferral provided under Section 451(c)
Impact of New Rules for Taxable Year of Inclusion

— Effective repeal of multi-year deferral previously provided under Treas. Reg. § 1.451-5 for advance payments received for goods

— Questions regarding extent of TR § 1.451-5 repeal due to electivity of Section 451(c) and exceptions to the new rules

— Whether administrative relief may be available for taxpayers that previously deferred under this provision or All Events Test
Impact of New Rules for Taxable Year of Inclusion

- Treas. Reg. § 1.451-4 has historically provided an exception to economic performance rules allowing an accelerated estimated cost of goods sold deduction for taxpayer issuing premium coupons (or trading stamps)
- Provision is used widely by taxpayers for rewards programs
- Some fear that the Service may conclude that there is no continuing need for the administrative deferral available under Treas. Reg. § 1.451-4 as a result of the new Sections 451(b) and (c) and adoption of ASC 606
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