Accounting Methods Update: Changes to Tax Rules Affecting Businesses and Individuals

ANDERSEN TAX®

The Tax Reform Act of 2017 (the Act) made a number of changes to the U.S. tax rules affecting businesses and individuals. Andersen Tax's Accounting Methods team is well-versed in the changes and prepared to assist you with planning and compliance in the context of the new rules. Below is a discussion of some of the legislative changes made by the Act and the impacts of the new provisions as they relate to accounting method considerations.

Reduced Corporate Tax Rate

The prior 35% top corporate rate is reduced to 21% under the Act for tax years beginning after 2017. This is a permanent reduction and accounting method changes should be considered to accelerate deductions and/or defer income given the reduced rate beginning on or after January 1, 2018. Corporate taxpayers with fiscal years that straddle the effective date of the new legislation can take advantage of a special blended tax rate. Fiscal year corporations may also be able to apply repealed deductions through their fiscal year (e.g., Sec. 199 domestic production deduction).

Income Recognition and the New GAAP / IFRS Revenue Recognition Standard

The Act revises Sec. 451 by requiring accrual-method taxpayers to recognize an item of income *no later* than the tax year in which it is recognized as revenue in the taxpayer's financial statement. The Act thus eliminates the possibility of a favorable book-tax difference related to unbilled revenue, a benefit that was relatively uncommon outside of the defense industry prior to new GAAP / IFRS revenue recognition standards (ASC 606 / IAS 15). The occurrence of unbilled revenue will become much more common following the implementation of ASC 606 / IAS 15, which is required for public businesses in 2018 and for private businesses in 2019. Now that book conformity is required, acceleration of book revenue recognition before the time of billing will also require acceleration of tax revenue recognition. Thus, income tax payments will become due in many cases before cash is received for the related revenue. This will likely have a significant impact in the software industry and may affect businesses in many different industries. Businesses should re-evaluate the cash-tax impact of ASC 606 / IAS 15 implementation in 2018 or 2019 (as applicable). For contracts that contain multiple performance obligations, the Act provides that taxpayers must allocate the transaction price among the performance obligations in the same manner for book and tax purposes. This may create simplification in light of the allocations that will be required to different performance obligations under ASC 606 / IAS 15.

Long-awaited IRS procedural guidance on the implementation of tax accounting method changes in light of ASC 606 / IAS 15 was delayed as a result of the changes in the Act. We expect guidance to be issued in the near future, as public businesses must reflect the tax impact of the new standard in their first quarter of 2018 tax provisions.

Deferral of Advanced Payments

The deferral provisions of Rev. Proc. 2004-34 are also codified into Sec. 451(c) by the Act. Rev. Proc. 2004-34 provided taxpayers with a limited one-year deferral beyond the tax year of receipt for certain advance payments. Only advance payments for goods and services are specifically referenced in the statutory language, which creates some uncertainty in terms of advance payments received for other items such as software or intellectual property. However, we expect IRS will issue guidance that allows the deferral method to continue to be used in all instances where Rev. Proc. 2004-34 applies. The Conference Report for the Act states that the intention was to repeal the longer deferral method that had been allowed under Treasury Regulation 1.451-5. Thus, starting in 2018, deferral will be limited to one year.

Valid as of 3/2018

The opinions and analyses expressed herein are subject to change at any time. Any suggestions contained herein are general, and do not take into account an individual's or entity's specific circumstances or applicable governing law, which may vary from jurisdiction to jurisdiction and be subject to change. Andersen Tax LLC is the U.S. member firm of Andersen Global, a Swiss verein comprised of legally separate, independent member firms located throughout the world providing services under their own name. Andersen Global does not provide any services and has no responsibility for any actions of the member firms, and the member firms have no responsibility for any actions of Andersen Global. No warranty or representation, express or implied, is made by Andersen Tax LLC, nor does Andersen Tax LLC accept any liability with respect to the information and data set forth herein. Distribution hereof does not constitute legal, tax, accounting, investment or other professional advice. Recipients should consult their professional advisors prior to acting on the information set forth herein. © 2018 Andersen Tax LLC. All rights reserved.

Increased Deductions for Bonus Depreciation

The Act amends Sec. 168(k)(1)(A) to allow taxpayers to expense the entire cost of certain depreciable assets acquired or placed in service after September 27, 2017 and before January 1, 2023 (with an additional year for aircraft and longer production period property). For property placed into service in calendar years 2023, 2024, 2025 and 2026, the applicable percentage that may be expensed is phased down (to 80%, 60%, 40%, and 20%, respectively). Special rules apply for qualified property acquired before September 28, 2017 and placed in service after September 27, 2017. Property is considered acquired no later than the date a written binding contract was entered into by the taxpayer. How to apply this written-binding-contract rule to self-constructed property and components is uncertain.

The definition of qualified property is modified under the Act as well. The requirement of original use is repealed, and the property qualifies if it is within the categories of property identified under Sec. 179(d) and it is the first use by the taxpayer. For property placed in service after 2017, the Act eliminates the separate definitions of qualified leasehold improvement, qualified restaurant, and qualified retail improvement property and instead groups these together as qualified improvement property (QIP). Although Congress likely intended to designate QIP as having a 15-year recovery period and 20-year alternative depreciation system period, the statute did not properly designate the recovery periods and additional guidance is needed to correct this omission. In the interim, the prior definitions apply through December 31, 2017, and property acquired and placed in service after September 28, 2017 through December 31, 2017 is eligible for full expensing.

Section 179 Expense

Section 179 was enacted to permit small businesses to deduct the cost of certain capital assets in one year, rather than to claim multiple deductions over a period of many years. Under the Act, the dollar limitation for a Sec. 179 deduction is increased to $1 million (double from the previous $500,000). The cost of property subject to the phase out is also increased to $2.5 million from $2 million. Both figures will be increased for inflation beginning in 2019. The definition of Sec. 179 property is also expanded under the Act to include certain depreciable tangible property used in connection with lodging as well as improvements to non-residential real property (e.g., roofs, heating, ventilation, air conditioning, and fire and alarm protection systems).

Repeal of Like-Kind Exchange Treatment for Personal Property

For exchanges completed after December 31, 2017, the Act limits the applicability of the like-kind exchange gain-deferral rules to like-kind exchanges of real property only. Thus, tangible personal property and intangible property is no longer eligible for like-kind exchange treatment. However, with respect to tangible personal property, the cost of the replacement property may be eligible for immediate expensing under the bonus depreciation or Sec. 179 rules, which could offset gain recognized on the exchange. The Act includes a transition rule for like-kind exchanges of personal property to be completed if the tax-payer had either disposed of the property, or acquired replacement property on or before December 31, 2017.

New Limits for Net Operating Losses

The Act limits a taxpayer's ability to utilize its NOL deduction in a year to 80% of taxable income for losses arising in tax years beginning after 2017. Carrybacks are eliminated for NOLs arising in a tax year ending after 2017. NOLs may be carried forward indefinitely. There is some uncertainty as to whether a technical correction may be needed regarding the effective date for the repeal of NOL carrybacks. The statute provides that the change applies for taxable years ending after 2017, thus

The opinions and analyses expressed herein are subject to change at any time. Any suggestions contained herein are general, and do not take into account an individual's or entity's specific circumstances or applicable governing law, which may vary from jurisdiction to jurisdiction and be subject to change. Andersen Tax LLC is the U.S. member firm of Andersen Global, a Swiss verein comprised of legally separate, independent member firms located throughout the world providing services under their own name. Andersen Global does not provide any services and has no responsibility for any actions of the member firms, and the member firms have no responsibility for any actions of Andersen Global. No warranty or representation, express or implied, is made by Andersen Tax LLC, nor does Andersen Tax LLC accept any liability with respect to the information and data set forth herein. Distribution hereof does not constitute legal, tax, accounting, investment or other professional advice. Recipients should consult their professional advisors prior to acting on the information set forth herein. © 2018 Andersen Tax LLC. All rights reserved.

fiscal year taxpayers could not carryback a NOL for any year ending after December 31, 2017. There is a discrepancy with the Conference Report, which states that carrybacks are repealed for taxable years beginning after December 31, 2017. Some Congressional staff members have indicated that this item should be corrected through a technical correction and that, lacking a technical correction, fiscal year taxpayers will not be able to carryback losses generated in taxable years ending after December 31, 2017.

In terms of the mandatory repatriation tax, discussed below, the Act allows taxpayers to preserve NOLs and opt out of utilizing them to offset the mandatory inclusion amount. This election may be desirable for taxpayers who can offset the repatriation tax with foreign tax credits.

Corporate Alternative Minimum Tax

The corporate alternative minimum tax (AMT) is repealed by the Act for tax years beginning after 2017. A taxpayer with an AMT carryforward may claim a refund of 50% of the remaining credits for any tax year beginning after 2017 and before 2022, or 100% for tax years beginning in 2021, where the credits exceed regular tax for such years. A refund may be claimed for any remaining AMT credit carryforwards beginning in 2021. Under pre-existing law, a taxpayer may accelerate AMT credit carryforwards in lieu of bonus depreciation for 2017, but AMT in lieu of bonus was repealed for taxable years beginning after December 31, 2017. The accelerated credits are refundable and subject to reduction by IRS for sequestration at the current applicable rate. Sequestration should be considered in assessing the ability to realize the full amount of AMT credit carryforwards.

Amortizing Research and Experimental Expenditures

The Act repeals expensing for research and experimental (R&E) expenditures, including software development costs, for tax years beginning after 2021. Such expenditures must instead be capitalized and amortized over a five-year period, or 15 years for research conducted outside the U.S. This change is in contradiction to Rev. Rul. 2000-50 which allowed taxpayers to expense current software development costs. The repeal also limits a taxpayer's ability to make Sec. 59(e) elections to amortize costs over 10 years for R&E expenditures incurred after 2021.

Certain Self-Created Property No Longer Capital Asset

Self-created patents, inventions, models or designs (whether patented or not), or secret formulas/processes are no longer considered capital assets for purposes of disposition of such property after December 31, 2017. Self-created goodwill is unaffected and continues to receive capital gain treatment. The election of capital treatment for self-created musical works continues to be available.

Meals and Entertainment

Section 274 is amended to disallow deductions for activities (and facilities used in connection with those activities) that are generally considered entertainment, amusement or recreation as well as membership dues with respect to a club organized for business, pleasure, recreation or social purposes. The 50% limitation for meals and entertainment applies only to expenses for food/beverages and there is no deduction for other entertainment activities.

The opinions and analyses expressed herein are subject to change at any time. Any suggestions contained herein are general, and do not take into account an individual's or entity's specific circumstances or applicable governing law, which may vary from jurisdiction to jurisdiction and be subject to change. Andersen Tax LLC is the U.S. member firm of Andersen Global, a Swiss verein comprised of legally separate, independent member firms located throughout the world providing services under their own name. Andersen Global does not provide any services and has no responsibility for any actions of the member firms, and the member firms have no responsibility for any actions of Andersen Global. No warranty or representation, express or implied, is made by Andersen Tax LLC, nor does Andersen Tax LLC accept any liability with respect to the information and data set forth herein. Distribution hereof does not constitute legal, tax, accounting, investment or other professional advice. Recipients should consult their professional advisors prior to acting on the information set forth herein. © 2018 Andersen Tax LLC. All rights reserved.

Compliance Considerations

The chart below provides compliance considerations with respect to business taxpayers filing 2017 and 2018 income tax returns, and for fiscal-year taxpayers that straddle both tax years. This list is not intended to be inclusive but only to highlight some of the most significant items that business taxpayers should consider in light of the recent tax reform changes.

2017 Income Tax Returns	Fiscal Year Taxpayers	2018 Income Tax Returns
Accounting Method Changes (Form 3115) – automatic changes are available, the due date has passed for non-automatic changes	Accounting Method Changes (Form 3115) – Non-automatic changes are due by the end of the fiscal year; automatic changes are available	Assess and correct impermissible methods through automatic or non-automatic procedure (as applicable); back-year audit protection and 4-year spread period applies to unfavorable changes
Changes in fact and confirmation of use of recurring item exception; payment within 2 ½ or 8 ½ months • Bonus plans • Rebates and allowances • Pension liabilities	Fact changes (i.e., use of prepayment planning – may require non-automatic change to adopt the 3 ½-month rule, bonus plan modifications, restricted stock units)	Interest limitations
Cost recovery (bonus depreciation)	Cost recovery (bonus depreciation)	Cost recovery (bonus depreciation)
Sec. 199 Planning	Sec. 199 applies to taxable years beginning before December 31, 2017; other permanent item changes based on date incurred may apply	Permanent item changes such as deductibility of meals and entertainment must be assessed and recordkeeping systems modified
NOL Planning; NOL carryback permitted	NOL Planning; NOL carryback not permitted	80% NOL limitation applies to losses generated in 2018 and future years
International Considerations (Form 5471) • Assess historical E&P • E&P automatic method changes (favorable v. unfavorable) for purposes of deemed repatriation tax		

Simplified Tax Compliance Measures for Small Businesses

Previously, C corporations or partnerships with a C corporation partner could only use the cash method of accounting if their average annual gross receipts for the prior three tax years did not exceed $5 million for all prior tax years. The Act increases the threshold to $25 million and the requirement that such businesses satisfy the gross receipts requirement for all prior tax years is repealed. The Act also makes other small business provisions available to taxpayers under the $25 million threshold. As under prior law, receipts are required to be aggregated for certain related parties for purposes of this threshold.

The opinions and analyses expressed herein are subject to change at any time. Any suggestions contained herein are general, and do not take into account an individual's or entity's specific circumstances or applicable governing law, which may vary from jurisdiction to jurisdiction and be subject to change. Andersen Tax LLC is the U.S. member firm of Andersen Global, a Swiss verein comprised of legally separate, independent member firms located throughout the world providing services under their own name. Andersen Global does not provide any services and has no responsibility for any actions of the member firms, and the member firms have no responsibility for any actions of Andersen Global. No warranty or representation, express or implied, is made by Andersen Tax LLC, nor does Andersen Tax LLC accept any liability with respect to the information and data set forth herein. Distribution hereof does not constitute legal, tax, accounting, investment or other professional advice. Recipients should consult their professional advisors prior to acting on the information set forth herein. © 2018 Andersen Tax LLC. All rights reserved.

- ***Exemption from inventory requirement*** – Businesses are generally required to use an inventory method of accounting if the production, purchase, or sale of merchandise is a material income-producing factor. Businesses required to use an inventory method must generally use the accrual method for tax purposes unless an exception applies. Thresholds were applied for taxpayers with under $1 million in gross receipts, or for those in certain industries under $10 million in gross receipts. The Act permits businesses with gross receipts under the $25 million threshold, including those with inventories, to use the cash method of accounting. If the gross receipts test is met then the inventory can be accounted for as either non-incidental materials and supplies, or consistent with the method of accounting used in its financial statements or books and records.

- ***Exemption from Sec. 263A*** – Taxpayers that produce real or tangible personal property, or acquire real or personal property to resell in the ordinary course of business, are subject to the uniform capitalization (UNICAP) rules which require that certain direct and indirect costs to the property be capitalized. While previously a taxpayer was not subject to the UNICAP rules in terms of personal property acquired for resale if its average annual gross receipts for the prior three tax years were $10 million or less, there was no exemption for taxpayers that produced real or tangible personal property or acquired real property. The Act provides an exemption from UNICAP for all business with gross receipts under the $25 million threshold.

- ***Exemption from Sec. 460*** – Prior law generally required that taxable income attributable to a long-term contract be determined under the percentage-of-completion method. The exception was for certain construction contracts expected to be completed within a two-year period from the contract commencement date and where the taxpayer had average annual gross receipts for the prior three tax years that did not exceed $10 million. The Act increased the $10 million threshold to $25 million, and a business below the increased threshold may use its overall method of accounting or any other permissible exempt contract method for construction contracts expected to be completed within a two-year period from the contract's commencement date.

A change in accounting method as a result of the provisions discussed above would be voluntary and would involve the filing of Form 3115, *Application for Change in Accounting Method*.

International Tax Provisions

The Act includes a mandatory repatriation tax on previously untaxed foreign earnings and profits (E&P). Taxpayers should review the accounting methods historically used in their foreign corporations. Computations of E&P may require accounting method changes to correct impermissible methods or adopt more favorable ones if permitted. In addition, the Act includes provisions related to Global Intangible Low Taxed Income (GILTI), for which purpose a business will need to compute the alternative tax depreciation system (ADS) basis in fixed assets of a foreign corporation. The Act also includes a base erosion anti-abuse tax (BEAT) which excludes costs of goods sold. In these contexts, it may become more important to classify costs into the proper tax category and to manage the amount of domestic income in any given taxable year. Accounting methods planning is a critical component of this effort.

The opinions and analyses expressed herein are subject to change at any time. Any suggestions contained herein are general, and do not take into account an individual's or entity's specific circumstances or applicable governing law, which may vary from jurisdiction to jurisdiction and be subject to change. Andersen Tax LLC is the U.S. member firm of Andersen Global, a Swiss verein comprised of legally separate, independent member firms located throughout the world providing services under their own name. Andersen Global does not provide any services and has no responsibility for any actions of the member firms, and the member firms have no responsibility for any actions of Andersen Global. No warranty or representation, express or implied, is made by Andersen Tax LLC, nor does Andersen Tax LLC accept any liability with respect to the information and data set forth herein. Distribution hereof does not constitute legal, tax, accounting, investment or other professional advice. Recipients should consult their professional advisors prior to acting on the information set forth herein. © 2018 Andersen Tax LLC. All rights reserved.

ANDERSEN TAX®

The Takeaway

The Act makes a number of changes to the tax rules affecting businesses and individuals. Taxpayers should consider accounting method changes to optimize their tax position in light of the new rules. Andersen Tax's accounting methods specialists are prepared to assist with an assessment of the new rules in the context of your current situation and to suggest appropriate strategies for addressing the changes discussed in this release.

For further information please contact:

Mary Duffy
mary.duffy@AndersenTax.com
+1.571.382.7672

Jessica Hawn
jessica.hawn@AndersenTax.com
+1.312.239.6152

Heather Roush
heather.roush@AndersenTax.com
+1.717.610.4390

The opinions and analyses expressed herein are subject to change at any time. Any suggestions contained herein are general, and do not take into account an individual's or entity's specific circumstances or applicable governing law, which may vary from jurisdiction to jurisdiction and be subject to change. Andersen Tax LLC is the U.S. member firm of Andersen Global, a Swiss verein comprised of legally separate, independent member firms located throughout the world providing services under their own name. Andersen Global does not provide any services and has no responsibility for any actions of the member firms, and the member firms have no responsibility for any actions of Andersen Global. No warranty or representation, express or implied, is made by Andersen Tax LLC, nor does Andersen Tax LLC accept any liability with respect to the information and data set forth herein. Distribution hereof does not constitute legal, tax, accounting, investment or other professional advice. Recipients should consult their professional advisors prior to acting on the information set forth herein. © 2018 Andersen Tax LLC. All rights reserved.