

# LB&I Training

# Tax Cuts & Jobs Act (TCJA)

Training  
Participant Guide  
October 2019

Official IRS Training Material

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# Welcome

## LB&I Tax Cuts & Jobs Act Training



# IRS Mission Statement



## **Mission Statement**

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Provide America's taxpayers top-quality service by helping them understand and meet their tax responsibilities and enforce the law with integrity and fairness to all.

# 14 General Principles of Ethical Conduct

Please see [Document 9300](#) for a complete list of the 14 General Principles of Ethical Conduct for Federal Employees.

# Taxpayer Bill of Rights

Please see [Publication 1](#) to read the full text of Your Rights as a Taxpayer.

# TCJA Course Overview

LB&I Tax Cuts & Jobs Act training sessions are a large part of LB&I's multi-pronged approach to tax reform training. This mandatory training course covers IRC § § 199A, 451, 163(j), 951A, 250, 59A, 965, 367 and 91.

# Table of Contents (as originally presented)

Course Agenda.....	9
IRC § 199A (Qualified Business Income Deduction).....	12
IRC § 451 (Income Recognition Guidance).....	105
IRC § 163(j) (Limitation on Business Interest Expense).....	180
IRC § 367 & 91 (Transfer Pricing/Outbound Transfers).....	366
IRC § 951A (Global Intangible Low-Taxed Income).....	409
IRC § 250 (Foreign Derived Intangible Income).....	493
IRC § 965 (Transition Tax).....	560
IRC § 59A (Base Erosion and Anti-abuse Tax).....	690

# TCJA Course Agenda

## **Monday - October 21, 2019**

- Executive Opening, Introductions and Admin
- IRC § 199A (Qualified Business Income Deduction)

## **Tuesday - October 22, 2019**

- IRC § 451 (Income Recognition Guidance)
- IRC § 163(j) (Limitation on Business Interest Expense)

## **Wednesday - October 23, 2019**

- IRC § 163(j) (Limitation on Business Interest Expense) (cont'd)
- IRC § 367 & 91 (Transfer Pricing/Outbound Transfers)

# TCJA Course Agenda (cont'd)

## **Thursday - October 24, 2019**

- IRC § 951A (Global Intangible Low-Taxed Income)
- IRC § 250 (Foreign Derived Intangible Income)

## **Tuesday - October 29, 2019**

- IRC § 965 (Transition Tax)

## **Wednesday - October 30, 2019**

- IRC § 59A (Base Erosion and Anti-abuse Tax)

## **Thursday – October 31, 2019**

- Final Comments and Executive Closing

# LB&I Training

## Tax Cuts & Jobs Act (TCJA)



IRC § 451 and Topic 606  
Income Recognition Guidance

# Instructor Introductions

## **Instructor Introductions**

# Disclaimer

- The IRC § 451 proposed regulations (NPRMs) were not issued in time for this training material.
- Additional training will be necessary when the NPRMs are issued and later become final. (Final guidance will consider public comments made with respect to the NPRM prior to its issuance.)

# Important Acronyms

- TCJA - “Tax Cuts and Jobs Act”
  - The law change initiated at the end of 2017. (mostly effective for tax years beginning in 2018)
- AFS - “Applicable Financial Statement”
  - The financial statements affected by the new IRC § 451 sections.

# Lesson Objectives

At the end of this lesson, participants will be able to:

- Measure the impact of Topic 606 on tax reporting,
- Describe the changes made by the TCJA to IRC § 451 sections - the new IRC § 451(b) and § 451(c), and
- Summarize the issued guidance related to those financial statement and tax reporting changes.

# Guidance

<b>Guidance</b>	<b>Purpose</b>	<b>Issued</b>
FASB - Topic 606	Financial Revenue Recognition Standards	May 2014
New §§ 451(b), (c)	Tax Law Change Income Reporting	Dec. 2017
Rev. Proc. 2018-29	Topic 606 DCN 231	Mar. 2018

# Guidance (cont'd)

<b>Guidance</b>	<b>Purpose</b>	<b>Issued</b>
<i>Notice 2018-35</i>	Tax Treatment of Advanced Payments prior to NPRM issuance	April 2018
<i>Notice 2018-80</i>	NPRM excludes Market Discount from § 451(b) treatment	Sept. 2018
Rev. Proc. 2018-60	§ 451(b) prior to NPRM - DCN 239	Nov. 2018

# TOPIC 606

# Topic 606

## Overview

- May 2014 - “Revenue from Contracts with Customers”
  - FASB “Update No. 2014-09 (Topic 606)”
  - IASB “IFRS 15”
- Common revenue recognition standards for both GAAP and IFRS financial statement preparation
- Replaced previous GAAP and IFRS guidance on revenue recognition from contracts with customers

# Topic 606

## Goals

- Remove inconsistencies in revenue requirements.
- Improve comparability of revenue recognition practices across entities, industries, and jurisdictions.
- Improve disclosure requirements.
- Simplify financial statements preparation.

# Topic 606

## Applicability

The standards apply to:

- an entity that enters into contracts with customers to transfer goods or services or nonfinancial assets, and
- an entity that prepares a financial statement for review by a public accounting firm to render an opinion on those statements.

# Topic 606

## Core Principles

When to recognize revenue for financial statement purposes:

“An entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for the goods or services.”

# Topic 606

## Key Take-Away

For financial reporting, Topic 606 may result in revenue being recognized sooner than it was prior to the adoption of Topic 606.

# Topic 606

## Five Steps

	Revenue Recognition Process
1	Identify the contract(s) with the customer.
2	Identify the <u>separate performance obligations</u> in the contract.
3	Determine the transaction price.
4	<u>Allocate the transaction price</u> to the separate performance obligations.
5	Recognize revenue when or as <u>performance obligations</u> are satisfied.

# Topic 606

## Advanced Payments

How are advanced payments treated under Topic 606 for financial reporting?

- Income may be deferred on advance payments until the performance obligation in the contract is completed.
- The following example from Topic 606 illustrates a typical transaction.

# Topic 606

## Advanced Payments - Example 52

- A retailer with a customer loyalty program will allocate the price between the goods sold and the loyalty points, both of which are deemed to be performance obligations.
- \$100,000 sale of goods with loyalty points:
  - Revenue of \$91,300 to be reported offset by cost of goods sold.
  - Liability (deferred revenue) of \$8,700 reflecting the obligation to perform (a performance obligation) upon redemption of those points.

# Topic 606

## Rev. Proc. 2018-29

- Applies to tax method changes made in the year when adopting Topic 606 or IFRS Standard 15 for:
  - (i) identifying performance obligations,
  - (ii) allocating transaction price to performance obligations, and/or
  - (iii) considering performance obligations satisfied.
- Provides a new automatic accounting method change (DCN 231) for a new method of accounting otherwise permissible under new IRC § 451.

# Rev. Proc. 2018-29 (cont'd)

New section 16.11(3)(a) of Rev. Proc. 2018-31 (“Inapplicability”) states that this change does not apply to:

- a change in the manner in which the taxpayer identifies contracts or determines the transaction price, **including the inclusion and exclusion of variable consideration in the transaction price**, under the New Standards.
- a change in method of accounting that does not comply with § 451 or other guidance.

# Topic 606

## Key Take-Aways

- For financial reporting, Topic 606 may result in revenue being recognized sooner than it was prior to Topic 606; thus, an agent must gauge the effect of the adoption of Topic 606 on tax reporting.
- For tax reporting, the effect of Topic 606 is seen in
  - the new IRC § 451(b), which has an AFS rule that is based upon the inclusion of revenue in the taxpayer's AFS, and
  - the new IRC § 451(c), which codifies the one-year deferral method and uses many of its key concepts and terminology.

# Questions



New

IRC § 451 (b)



# IRC § 451

## Timing of Income

In general, IRC § 451 provides:

- that the amount of any item of gross income is included in gross income for the taxable year in which it is received by the taxpayer,
- unless, under the method of accounting used in computing taxable income, the amount is to be properly accounted for as of a different period.

# IRC § 451

## All-Events Test

The Taxpayer generally recognizes items of income **when**

- All the events have occurred that fix the right to receive the income and
- The amount can be determined with reasonable accuracy.

# All-Events Test

## Fixed Right to Receive Income

Taxpayers generally have a fixed right to receive income upon the earlier of when an amount is:

- Due
- Paid
- Earned

# New IRC § 451(b) Overall Theme

- The New IRC § 451(b) contains an “AFS Rule”.
- However, there are items excluded from the changes to § 451(b).

# IRC § 451(b) Statutory change

IRC § 451(b)(1)(A) post-TCJA now provides:

- if you are an accrual method taxpayer with an Applicable Financial Statement,
- the all-events test with respect to any item of gross income, is treated as met no later than when such item, or portion thereof, has been taken into account as revenue in the AFS or other specified financial statement.

# IRC § 451 (b)(1)(A) and (B)

## AFS Rule

- The AFS Rule generally applies to:
  - accrual method taxpayers
  - that file an “Applicable Financial Statement”
  - and are subject to the all-events test.
- This rule operates to accelerate income inclusion.
- Exceptions to § 451(b)(1)(A) contained in section (B):
  - The rule does not apply to a taxpayer which does not have an AFS or other specified statement for a tax year.
  - The rule does not apply to a mortgage servicing contract.

# IRC § 451(b)(2) AFS Rule

- The AFS rule generally does not apply to “special methods of accounting”.
- “Special Method of accounting” is not defined in the statute.
- Conference Report suggests a special method of accounting may include:
  - Methods of accounting provided in IRC § 453 (Installment method)
  - Methods of accounting in IRC § 460
  - (Long-term contracts method)

# “Applicable Financial Statement” defined and Priority Order

- Certified GAAP financial statement filed with SEC.
- Certified GAAP financial statement
  - used for credit purposes,
  - used to report to shareholders, partners, other proprietors, or beneficiaries
  - used for any other substantial nontax purpose
  - filed with any other Federal agency for nontax purposes

# “Applicable Financial Statement” defined and Priority Order (cont’d)

- Certain financial statements prepared using International Accounting Standards (IFRS).
- Financial statement filed with any other regulatory or governmental body specified by the Secretary.

# AFS Rule

## Example: Unbilled Receivables

The Conference Report suggests that IRC § 451(b) and the AFS Rule apply to unbilled receivables for services included in revenue for AFS purposes.

# AFS Treatment

## Variable Consideration

- For AFS purposes, taxpayers may be required to take into account variable consideration when determining the transaction price of an item in a contract.
- What is “variable consideration”?
  - Discounts, rebates, refunds, credits, price concessions, incentives, performance bonuses, penalties, and other similar items.

# Tax Treatment Variable Consideration

- The AFS Rule was intended to change only the timing of income.
  - The AFS Rule ensures that those items of income are not included later than when they are included for AFS purposes.
- Variable consideration could increase or decrease revenue.
  - We hope guidance further clarifies this issue.

# Rev. Proc. 2018-60

- Procedures for obtaining the automatic consent of the Commissioner to change a method of accounting to comply with § 451(b)(1)(A) and/or 451(b)(4), as amended by TCJA (DCN 239).
- Enables a taxpayer to change its accounting method to comply with IRC § 451(b), the AFS Rule added by the TCJA.
- For the first taxable year that begins after Dec. 31, 2017, certain taxpayers are permitted to make a method change to comply with IRC § 451(b) without filing a Form 3115.

# New IRC § 451(b) Key Take-Aways

- If income is accelerated for financial reports, it is generally accelerated for tax purposes under IRC § 451(b)(1)(A).
- There are items not brought in by IRC § 451(b)(1)(A).

# Questions



New

IRC § 451(c)



# New IRC § 451(c) Overall Theme

- New IRC § 451(c) generally codifies the one-year deferral method previously provided in Rev. Proc. 2004-34.
- Rev. Proc. 2004-34 provides for a one-year deferral method for goods and services, or other specified items.

# Advance Payments

## Before TCJA: Deferral Rules

- Taxpayer receiving an advance payment for goods or services generally includes such payment in income in the year of receipt under the all-events test.
- Prior to the TCJA, a taxpayer could elect to apply one of these special deferral rules:
  - One-year deferral - Rev. Proc. 2004-34
  - Two-year deferral - Treas. Reg. 1.451-5(c)
  - Multi-year deferral - Treas. Reg. 1.451-5(b)(1)(ii)

# Advance Payments

## After TCJA: New IRC § 451(c)

Under new IRC § 451(c), Taxpayers may defer including all or a portion of an advance payment for goods or services in income until the following tax year to the extent such amount is not required to be included in income under section 451(b).

# Notice 2018-35

- Allows taxpayers to continue to rely on Rev. Proc. 2004-34 for their treatment of advance payments until such guidance is effective;
- Provides that the Service intends to issue guidance for the treatment of advance payments under IRC § 451(c); and
- Requests comments regarding issues concerning advance payments, with a focus on guidance regarding the definition and requirement of AFS.

# New IRC § 451(c) Deferral

- The statute permits deferral of advance payments received to the extent, in the year of receipt, the amount is not required to be included in income under section 451(b).
- The amounts not included in gross income in the year of receipt must be included in gross income in the next taxable year.
- Consistent with the 1-year deferral provided in Rev. Proc. 2004-34.

# New IRC § 451(c)(4)(A) Advance Payment - Definition

The definition of advance payment is similar to the definition of advance payment in Rev. Proc. 2004-34.

# New IRC § 451(c)(4)(A)

## Advance Payment – Definition (cont'd)

- Full inclusion in gross income for the taxable year of receipt is a permissible method of accounting
- Any portion of which is included in revenue by the taxpayer in an AFS for a subsequent taxable year
- For goods, services, or such other items as may be identified by the Secretary.

# Advance Payments Deferral Example

- Taxpayer agrees to manufacture 500 widgets for a customer at a price of \$10 each.
- In Year 1, Taxpayer receives prepayment of \$5,000.
- In Year 2 and 3, Taxpayer manufactures the widgets.
- In Year 3, Taxpayer delivers all 500 widgets to customer.
- In Year 3's financial statements, the \$5,000 prepayment is included in revenue.

# Pre TCJA vs. Post TCJA Deferral Rules

- Pre TCJA: Under the IRC § 451 “all-events” test (absent a special rule allowing deferral): Taxpayer recognizes \$5,000 in income in Year 1 (*i.e.*, in the year of receipt).
- Pre TCJA: The taxpayer could elect to apply special deferral rules: One-year deferral, Two-year deferral, Multi-year deferral.
- Post TCJA: Under **new IRC § 451(c)**, the taxpayer may elect to apply the **one-year deferral**.

# Treas. Reg. § 1.451-5

- Effective July 15, 2019, Treas. Reg. § 1.451-5 was revoked.
- These are the two-year deferral and multi-year deferral methods.

# Rev. Proc. 2004-34

## Advance Payments

- Services
- Sale of goods
- Use of intellectual property
- Occupancy or use of property if the occupancy or use is ancillary to the provision of services
- Sale, lease, or license of computer software
- Guaranty or warranty contracts ancillary to an item or items described in earlier paragraphs
- Subscriptions
- Memberships in an organization
- Eligible gift card sale

# IRC § 451(c) (4)(B)

## Advance Payments - Exclusions

- Rent
- Insurance premiums governed by Subchapter L
- Payments with respect to financial instruments
- Payments with respect to warranty / guarantee contracts with third party as the primary obligor.
- Payments subject to sections 871(a), 881, 1441, or 1442
- Payments in property to which section 83 applies
- Other payments identified by the Secretary.

# Acceleration Rules

- The new IRC § 451(c) and Rev. Proc. 2004-34 provide if the taxpayer ceases to exist, the taxpayer can no longer defer the recognition of the income from the advanced payment for tax purposes.
- Additionally, Rev. Proc. 2004-34 provides the recognition of an advance payment when a taxpayer's obligation with respect to an advance payment is satisfied or otherwise ends.

# IRC §451(b)(4) and (c)(4)(D)

- In the case of a contract which contains multiple performance obligations, the statute requires the taxpayer to allocate the transaction price to each performance obligation in accordance with the allocation made in the taxpayer's AFS.
- The provision does not apply to taxpayers without an AFS.

# Example 1

## Allocable Payment - Rev. Proc. 2004-34

- Q is in the business of selling and licensing computer software (off the shelf, fully customized, and semi-customized) and providing customer support.
- On July 1, 2018, Q receives an advance payment of \$100 for a 2-year software license agreement that
  - includes a 1-year “software maintenance contract” under which Q will provide software updates if it develops an update within the contract period, and online and telephone customer support, as well.

# Example 1

## Allocable Payment (cont'd) 1

- In its AFS, Q allocates \$20 of the payment to the maintenance contract and \$80 to the license agreement.
- With respect to the \$20 allocable to the maintenance contract, Q includes
  - 1/2 (\$10) in revenue for 2018
  - the remaining 1/2 (\$10) in revenue for 2019
  - regardless of when Q provides updates or customer support
- With respect to the \$80 allocable to the license agreement, Q includes
  - 1/4 (\$20) in revenue for 2018 (6 months/24 months)
  - 1/2 (\$40) in revenue for 2019 (12 months/24 months)
  - the remaining 1/4 (\$20) in revenue in 2020 (6 months/24 months)

# Example 1

## Allocable Payment (cont'd) 2

For federal income tax purposes, Q must include:

- \$30 in gross income for 2018
  - \$10 allocable to the maintenance contract
  - \$20 allocable to the license agreement
- the remaining \$70 in gross income for 2019

## Example 2

### Goods and Services - Rev. Proc. 2004-34

- On June 1, 2018, B, a landscape architecture firm, receives an advance payment for goods and services that, under the terms of the agreement, must be provided by December 2019.
- On December 31, 2018, B estimates that 3/4 of the work under the agreement has been completed.

# Example 2

## Goods and Services (cont'd)

- In its AFS, B includes
  - $\frac{3}{4}$  of the payment in revenue for 2018
  - $\frac{1}{4}$  of the payment in revenue for 2019
- B uses the deferral method so for federal income tax purposes, B must include
  - $\frac{3}{4}$  of the payment in gross income for 2018
  - the remaining  $\frac{1}{4}$  of the payment in gross income for 2019 regardless of whether B completes the job in 2019

# Example 3

## Gift Cards – Rev. Proc. 2004-34

- F, a hair styling salon, receives advance payments for gift cards that may later be redeemed at the salon for hair styling services or hair care products at the face value of the gift card.
- The gift cards look like standard credit cards, and each gift card has a magnetic strip that, in connection with F's computer system, identifies the available balance.
- The gift cards may not be redeemed for cash and have no expiration date.

# Example 3

## Gift Cards (cont'd)

- In its AFS, F includes advance payments for gift cards in revenue when redeemed.
- F is not able to determine the extent to which advance payments are included in revenue in its AFS for the taxable year of receipt which is a requirement to use the deferral method under Rev. Proc. 2004-34.
- Therefore, F may not use the deferral method under Rev. Proc. 2004-34 for these advance payments.

# Example 4

## Gift Cards - Rev. Proc. 2004-34

Same facts as prior example except that

- The gift cards have an expiration date 12 months from the date of sale,
- F does not accept expired gift cards, and
- F includes unredeemed gift cards in revenue in its AFS for the taxable year in which the cards expire.

# Example 4

## Gift Cards (cont'd)

- F tracks the sale date and the expiration date of the gift cards for purposes of its AFS; therefore, F is able to determine the extent to which advance payments are included in revenue for the taxable year of receipt.
- Therefore, F meets the requirement of section 5 of Rev. Proc. 2004-34 and may use the deferral method under Rev. Proc. 2004-34 for these advance payments.

# Example 5

## Membership Fees Rev. Proc. 2004-34

- On December 1, 2018, J, in the business of operating a chain of “shopping club” retail stores, receives advance payments for membership fees.
- Upon payment of the fee, a member is allowed access for a 1-year period to J's stores, which offer discounted merchandise and services.

# Example 5

## Membership Fees (cont'd)

- In its AFS, J includes
  - 1/12 of the payment in revenue for 2018
  - 11/12 of the payment in revenue for 2019
- J uses the deferral method under Rev. Proc. 2004-34 so for federal income tax purposes, J must include
  - 1/12 of the payment in gross income for 2018
  - the remaining 11/12 of the payment in gross income for 2019

# Taxpayers without an AFS

## Rev. Proc. 2004-34

A taxpayer without an AFS must be able to determine the extent to which advance payments are earned in the taxable year of receipt.

# Taxpayers without an AFS

## Rev. Proc. 2004-34 Example

- G is in the business of operating video arcades.
- G receives payments for game tokens used by customers to play the video games.
- G completed a study on a statistical basis, based on adequate data available to G, and concluded that for payments received in the current year,
  - X percent of tokens are expected to be used in the current year,
  - Y percent of tokens are expected to be used in the next year, and
  - the remaining Z percent of tokens are expected to never be used.

# Taxpayers without an AFS

## Example (cont'd)

- G treats as earned for 2018 X percent as well as Z percent.
- G is able to determine the extent to which the payment is earned in the taxable year of receipt on a statistical basis.
- For tax purposes, G must include the X percent and Z percent of the advance payment in 2018, and Y percent of the advance payments in gross income for 2019.

# Method of Accounting

- The use of the deferral method under § 451(c) is a method of accounting under section 446.
- A change in the manner of recognizing advance payments in revenue is a change in method of accounting under section 446 and the accompanying regulations.

# “New” IRC § 451(c) Key Take-Away

One-year deferral rule (similar to Rev. Proc. 2004-34) is now in the Code via the new IRC § 451(c).

# Questions



# Financial Products & New IRC § 451



# Rules for Certain Debt Instruments

- New IRC § 451(b) overturns the tax treatment of credit card late fees, cash advance fees, and interchange fees – and instead subjects these fees to the AFS rule described previously.
- Note: the inclusion of this income under IRC § 451(b) applies to taxable years beginning after December 31, 2018.

# Exam Resources



# MAT PN Resources

- Published Regulations (when available)
- Content & Tools
- Community Calls & Training
- Request Tracker

# MAT PN

## Basic Audit Steps

- Obtain an understanding of the book entries and the tax return treatment (M adjustments, etc.).
- Obtain and read applicable contracts or other documentation.
- If needed, submit an inquiry summarizing the facts and the potential issue.

# Lesson Summary

You are now able to:

- Measure the impact of Topic 606 on tax reporting,
- Describe the changes made by the TCJA to IRC § 451 sections - the new IRC § 451(b) and § 451(c), and
- Summarize the issued guidance related to those financial statement and tax reporting changes.

# Questions



Thank You

Thank you for your participation!