



TaxNewsFlash

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Notice 2018-35: Transitional guidance, accrual method taxpayers deferring advance payments from income

The IRS today released an advance version of Notice 2018-35 to provide transitional guidance under new Code section 451(c), which allows accrual method taxpayers to elect a limited deferral of the inclusion of income associated with certain advance payments.

Notice 2018-35 [PDF 23 KB] states that the rules in new Code section 451(c) largely track the approach taken by the IRS in Rev. Proc. 2004-34, and that the IRS and Treasury Department expect to issue future guidance regarding the treatment of advance payments to implement this legislative change.

Today's IRS notice states that taxpayers (with or without applicable financial statements) receiving advance payments may continue to rely on Rev. Proc. 2004-34 until future guidance is effective.

Background

The new tax law (Pub. L. No. 115-97, enacted December 22, 2017) added section 451(c) to the Code effectively to codify a deferral method of accounting for advance payment for goods and services, as previously allowed under Rev. Proc. 2004-34. New section 451(c) allows accrual method taxpayers to elect a limited deferral of income associated with certain advance payments.

Rev. Proc. 2004-34 [PDF 108 KB] provides two methods of accounting for the treatment of advance payments for goods, services, and other designated items:

- The full inclusion method provides that advance payments are included in income in the year of receipt.

- The deferral method provides that an advance payment is included in gross income in the tax year of receipt to the extent recognized in a taxpayer's applicable financial statement for that tax year or earned (for those taxpayers without an applicable financial statement) in that tax year, and the remainder of the advance payment is included in the next succeeding tax year (the tax year after the tax year in which the payment is received).

The new tax law provides that an accrual method taxpayer generally must include an advance payment in gross income in the tax year of receipt, but alternatively, that accrual method taxpayers may elect to defer the recognition of all (or a portion) of an advance payment to the tax year following the tax year of receipt—except for the portion of the advance payment that must be included in gross income in the year of receipt pursuant to section 451(b).

Interim guidance

Today's IRS notice states that the Treasury and IRS expect to issue guidance for the treatment of advance payments to implement the changes to section 451 made by the new tax law. Until that guidance is issued, taxpayers may continue to rely on Rev. Proc. 2004-34 for the treatment of advance payments.

Today's notice states that the IRS will not challenge a taxpayer's use of Rev. Proc. 2004-34 to satisfy the requirements of section 451, but that the IRS "will continue to verify on examination that taxpayers are properly applying Rev. Proc. 2004-34."

The IRS also intends to modify Rev. Proc. 2017-30 to enable taxpayers to make a change to a method of accounting that is permitted under Rev. Proc. 2004-34, and to waive the general limitation under which the same method of accounting may not be changed automatically twice within the same five tax years.

Comments are requested as to the future guidance, and are due by May 14, 2018.

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