

26 CFR 601.204: Changes in accounting periods and method of accounting.
(Also: Part I, Sections 446, 451; 1.451-1.)

Notice 2018-35

SECTION 1. PURPOSE

This notice provides transitional guidance relating to advance payments under Rev. Proc. 2004-34, 2004-1 C.B. 991, as modified and clarified by Rev. Proc. 2011-18, 2011-5 I.R.B. 443, and Rev. Proc. 2013-29, 2013-33 I.R.B. 141, and as modified by Rev. Proc. 2011-14, 2011-4 I.R.B. 330. Section 13221 of “An Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018,” Pub. L. No. 115-97 (December 22, 2017) (the “Act”) amended § 451 of the Internal Revenue Code. The amendments included a new section 451(c), which allows accrual method taxpayers to elect a limited deferral of the inclusion of income associated with certain advance payments. The rules in new § 451(c) largely track the approach in Rev. Proc. 2004-34. The Department of the Treasury (Treasury Department) and the Internal Revenue Service (the Service) expect to issue future guidance regarding the treatment of advance payments to implement this legislative change. Taxpayers, with or without applicable financial statements, receiving advance payments may continue to rely on Rev. Proc. 2004-34 until future guidance is effective.

SECTION 2. BACKGROUND

Section 451(a) provides that the amount of any item of gross income is included in gross income for the taxable year in which 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.

Section 1.451-1(a) of the Income Tax Regulations provides that, under an accrual method of accounting, income is includible in gross 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 the events that fix the right to receive income generally occur when: (1) the payment is earned through performance, (2) payment is due to the taxpayer, or (3) payment is received by the taxpayer, whichever happens earliest. See Rev. Rul. 2003-10, 2003-1 C.B. 288.

Rev. Proc. 2004-34 provides a full inclusion method (the Full Inclusion Method) and a deferral method (the Deferral Method) of accounting for the treatment of advance payments for goods, services, and other items. Under the Full Inclusion Method, advance payments are included in income in the year of receipt. Under the Deferral Method, an advance payment is included in gross income for the taxable year of receipt to the extent recognized in revenue in a taxpayer's applicable financial statement for that taxable year or earned (for taxpayers without an applicable financial statement) in that taxable year, and the remaining amount of the advance payment is included in the next succeeding taxable year after the taxable year in which the payment is received.

Section 13221 of the Act amends § 451 by redesignating subsections (b) through (i) as (d) through (k), respectively, and by inserting new subsections (b) and (c),

effective generally for taxable years beginning after December 31, 2017. Section 451(b)(1)(A)(i) provides that for an accrual method taxpayer, the all events test for any item of gross income shall not be treated as met any later than when the item is taken into account as revenue in an applicable financial statement of the taxpayer. Section 451(c)(1)(A) generally provides that an accrual method taxpayer shall include an advance payment in gross income in the taxable year of receipt. Alternatively, under § 451(c)(1)(B), an accrual method taxpayer may elect to defer the recognition of all or a portion of an advance payment to the taxable year following the taxable year in which the payment is received, except any portion of such advance payment that is required under § 451(b) to be included in gross income in the taxable year in which the payment is received.

Section 451(c)(4)(A) defines an advance payment as any payment: (1) the full inclusion of which in the gross income of the taxpayer for the taxable year of receipt is a permissible method of accounting, (2) any portion of which is included in revenue by the taxpayer in an applicable financial statement, or such other financial statement as the Secretary may specify, for a subsequent taxable year, and (3) which is for goods, services, or such other items as may be identified by the Secretary. Section 451(c) generally contains rules similar to Rev. Proc. 2004-34. See H.R. Rep. No. 115-466, at 429 (2017) (Conf. Rep.).

SECTION 3. INTERIM GUIDANCE FOR REV. PROC. 2004-34

The Treasury Department and the Service expect to issue guidance for the treatment of advance payments to implement the changes made to § 451 by the Act. Until further guidance for the treatment of advance payments is applicable, taxpayers

may continue to rely on Rev. Proc. 2004-34 for the treatment of advance payments. During this time, the Service will not challenge a taxpayer's use of Rev. Proc. 2004-34 to satisfy the requirements of § 451, although the Service will continue to verify on examination that taxpayers are properly applying Rev. Proc. 2004-34. In addition, the Service intends to modify section 16.07 of Rev. Proc. 2017-30, 2017-18 I.R.B. 1131, to provide a waiver of the eligibility rule in section 5.01(1)(f) of Rev. Proc. 2015-13, 2015-5 I.R.B. 419, to enable taxpayers to make a change to a method of accounting that is permitted under Rev. Proc. 2004-34.

SECTION 4. REQUEST FOR COMMENTS ON ADVANCE PAYMENTS

The Treasury and Service invite comments containing suggestions for future guidance under § 451(b) and (c). In particular, comments are requested concerning the following issues under § 451(c): (1) whether taxpayers without an applicable financial statement may continue to use the Deferral Method, as provided in Rev. Proc. 2004-34; (2) whether clarity is needed for the definition of an applicable financial statement under § 451(b)(3); (3) whether the definition of applicable financial statement under § 451(b) and (c) should be the same as the definition in section 4.06 of Rev. Proc. 2004-34; (4) whether other items in addition to those listed in section 4.01(3) of Rev. Proc. 2004-34 should be included in the definition of an advance payment; (5) whether certain payments other than those listed in section 4.02 of Rev. Proc. 2004-34 should be excluded from the definition of an advance payment; (6) whether any new procedural rules for changing a method of accounting for advance payments would be appropriate and helpful; and (7) the extent, if any, to which the Service may provide procedures expanding the rules of § 451(c) to apply to additional taxpayers and types of income.

WHERE TO SEND COMMENTS

Comments must be submitted by May 14, 2018. Comments, identified by Notice 2018-35, may be sent by one of the following methods:

- By Mail:

Internal Revenue Service
Attn: CC:PA:LPD:PR (Notice 2018-35)
Room 5203
P.O. Box 7604
Ben Franklin Station
Washington, DC 20044

- By Hand or Courier Delivery: Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to:

Courier's Desk
Internal Revenue Service
Attn: CC:PA:LPD:PR
(Notice 2018-35)
1111 Constitution Avenue, NW
Washington, DC 20224

- Electronic: Alternatively, persons may submit comments electronically to Notice.Comments@irs.counsel.treas.gov. Please include "Notice 2018-35)" in the subject line of any electronic communications.

All submissions will be available for public inspection and copying in room 1621, 1111 Constitution Avenue, NW, Washington, DC, from 9 a.m. to 4 p.m.

SECTION 5. DRAFTING INFORMATION

The principal author of this notice is Peter E. Ford of the Office of Associate Chief Counsel (Income Tax & Accounting). For further information regarding this notice, contact Peter E. Ford, at (202) 317-7011 (not a toll-free call).