



July 9, 2013

Mr. Andrew Keyso, Jr.
Associate Chief Counsel
(Income Tax & Accounting)
Internal Revenue Service
1111 Constitution Avenue, N.W.
Washington, D.C. 20224

Re: Comments and Recommendations for Procedural Changes in Response to Ambiguities Raised in Complying with Final Regulations under Sections 381(c)(4) and 381(c)(5) (TD 9534)

Dear Mr. Keyso:

The American Institute of Certified Public Accountants (AICPA) appreciates this opportunity to submit comments with respect to the final Regulations under sections 381(c)(4) and 381(c)(5) (TD 9534). These comments were developed by the Section 381 Task Force of the AICPA's Tax Methods and Periods Technical Resource Panel, and approved by the Tax Executive Committee.

The AICPA is the world's largest membership association representing the accounting profession, with nearly 386,000 members in 128 countries and a 125-year heritage of serving the public interest. Our members advise clients on federal, state and international tax matters and prepare income and other tax returns for millions of Americans. Our members provide services to individuals, not-for-profit organizations, small and medium-sized businesses, as well as America's largest businesses.

Executive Summary

This letter addresses some ambiguities that we have identified in the application of the final regulations under sections 381(c)(4) and 381(c)(5), and provides suggestions as to how the regulations could be modified to address these issues to prevent controversy in this area.¹

The AICPA believes that the rule in Treas. Reg. § 1.381(c)(4)-1(c)(1) should be modified to provide that a change to the principal method is only required when the trades or businesses of the acquiring corporation and the distributor or transferor are not operated as separate and distinct trades or businesses in the year of the section 381(a) transaction.

In addition, the AICPA recommends that sections 4.02(6) and (7) of Rev. Proc. 2011-14 be modified to indicate that, for purposes of determining whether a taxpayer has made a change in

¹ For simplicity, the discussion below is limited to the regulations under section 381(c)(4), but the same issues exist in the regulations under section 381(c)(5).

method of accounting in the prior five years, a change to a principal method required by operation of section 381(c)(4) or 381(c)(5) should not be taken into account.

Background

On July 29, 2011, the Internal Revenue Service (IRS or “Service”) and the Department of the Treasury (“Treasury”) published final regulations under sections 381(c)(4) and 381(c)(5), which are effective for transactions described in section 381(a) occurring on or after August 31, 2011.

Under the final regulations, the acquiring corporation must first determine if the distributor or transferor corporation's trades or businesses will be operated as separate trades or businesses by the acquiring corporation, or whether they will be integrated into a trade or business of the acquiring corporation. Pursuant to Treas. Reg. § 1.381(c)(4)-1(e)(4)(ii), such a determination is made based on the facts and circumstances known as of the date of the distribution or transfer. Treas. Reg. § 1.381(c)(4)-1(e)(4)(ii) further provides that the intent to combine the books and records of the acquiring corporation and the distributor or transferor can be demonstrated through contemporaneous records or documents, or other objective evidence reflecting the acquiring corporation's ultimate plan of operation, even if the combination of the books and records of the acquiring corporation and the distributor or transferor occurs in a taxable year subsequent to the taxable year in which the distribution or transfer occurred.

Additionally, Treas. Reg. § 1.381(c)(4)-1(a)(2) provides that, if the acquiring corporation intends to operate the trades or businesses of the parties to the section 381(a) transaction as separate trades or businesses after the transaction, the method of accounting (either the overall method of accounting or any special method of accounting) used by the parties prior to the section 381(a) transaction generally will carry over and will be used by the acquiring corporation after the transaction unless the carryover method is impermissible or the acquiring corporation chooses to file a voluntary request for change in method of accounting.

Conversely, Treas. Reg. § 1.381(c)(4)-1(a)(3) provides that, if the acquiring corporation intends to operate the trades or businesses of the parties to the section 381(a) transaction as an integrated trade or business after the date of distribution or transfer, the acquiring corporation must use the principal method of accounting, unless the principal method is impermissible, or the acquiring corporation requests permission to change the principal method of accounting. A trade or business that will be combined and integrated after a section 381(a) transaction is referred to as a “component trade or business.”

Determining the principal method

Treas. Reg. § 1.381(c)(4)-1(c)(1) provides that, in general, the principal method of accounting will be the method used by the acquiring corporation immediately before the date of the distribution or transfer. However, there are two exceptions to this rule. First, Treas. Reg. § 1.381(c)(4)-1(c)(1) provides that, if the trade or business of the distributor or transferor is larger than that of the acquiring corporation on the date of the distribution or transfer, the principal method of accounting will be that of the distributor or transferor immediately before the date of the distribution or transfer. Second, if the larger trade or business (whether it be that of the

acquiring corporation or the distributor or transferor) does not have a special method of accounting for an item immediately prior to the date of distribution or transfer, the principal method of accounting will be the special method of accounting used by the trade or business that does have a method of accounting for that item.

In some cases, the parties to a section 381(a) transaction may operate multiple trades or businesses and may use different methods of accounting for those trades or businesses. In those situations where there may be more than one principal overall method, or more than one principal special method of accounting for a particular item, Treas. Reg. § 1.381(c)(4)-1(c)(2) provides that the acquiring corporation may choose which of the principal methods of accounting will be used by the trades or businesses so long as the method that is chosen is a permissible method of accounting.

Accounting method changes to a principal method

In general, Treas. Reg. §§ 1.381(c)(4)-1(a)(2) and 1.381(c)(4)-1(d)(1)(i)(A) provide that an acquiring corporation that either uses a permissible carryover method or changes to the principal method of accounting as a result of applying the rules discussed above will not be required to request permission from the IRS to change the method of the accounting.

Pursuant to Treas. Reg. § 1.381(c)(4)-1(d)(1)(i)(A), any change to a principal method of accounting is treated as having been initiated by the acquiring corporation and must be reflected in the acquiring corporation's federal income tax return for the taxable year that includes the date of the distribution or transfer. The regulations further provide that the amount of the section 481(a) adjustment, and the period over which such adjustment will be taken into account, are determined under the regulations governing accounting method changes, as well as the applicable administrative procedures that govern voluntary changes in method of accounting. Thus, the regulations provide that, if a particular change in method of accounting is required to be implemented with a section 481(a) adjustment, the acquiring corporation must determine the section 481(a) adjustment as of the beginning of the day that is immediately after the date of the distribution or transfer and report such amount in its federal income tax return for the taxable year that includes the date of the distribution or transfer, and any subsequent taxable years as required.

While changes to a principal method are generally subject to the same terms and conditions and administrative procedures as a voluntary method change, there are two notable differences. First, Treas. Reg. § 1.381(c)(4)-1(d)(1)(iii) provides that the scope limitations in the applicable administrative procedures will not apply to a change to a principal method. The other, more notable, difference is that, pursuant to Treas. Reg. § 1.381(c)(4)-1(d)(1)(ii), a change to a principal method does not receive audit protection.

Scope restrictions for automatic accounting method changes

A taxpayer that wishes to change either its overall method of accounting or the method of accounting for a specific item generally must follow the applicable administrative procedures that govern voluntary changes in method of accounting. Rev. Proc. 2011-14, 2011-4 I.R.B. 330,

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sets forth the procedures pursuant to which a taxpayer may obtain automatic consent to change a method of accounting. However, there are certain situations where Rev. Proc. 2011-14 is not applicable, including when a taxpayer has changed the same method of accounting in the last five taxable years.

Specifically, sections 4.02(6) and (7) of Rev. Proc. 2011-14, provide that, in general, a taxpayer may not obtain automatic consent to change a method of accounting if the taxpayer changed either its overall method of accounting or the method of accounting for a specific item within the last five taxable years, including the year of change. This limitation applies if the taxpayer actually changed its method or applied for consent to change a method, regardless of whether the change was implemented, and regardless of the administrative guidance used to request consent or to change the prior method of accounting.

Issues

Anticipated integration of trades or businesses

The AICPA believes that the final regulations under sections 381(c)(4) and 381(c)(5) largely achieve the stated goal of clarifying and simplifying the rules regarding methods of accounting to be used by an acquiring corporation following a section 381(a) transaction. However, the AICPA believes that the final regulations do not provide guidance addressing application of the regulations in cases where the taxpayer's documentation evidences an intent to integrate trades or businesses of the transferor and transferee, but where such integration either occurs in a year subsequent to the year of the section 381(a) transaction or never occurs.

As noted above, the intent to combine the books and records of the acquiring corporation and the distributor or transferor can be demonstrated through contemporaneous records or documents, or other objective evidence reflecting the acquiring corporation's ultimate plan of operation, even if the combination of the books and records of the acquiring corporation and the distributor or transferor occurs in a taxable year subsequent to the taxable year in which the distribution or transfer occurred. Therefore, it appears that, based solely on the intent to combine the books and records of the acquiring corporation and the distributor or transferor and to operate the trades or businesses of the parties as an integrated trade or business, the acquiring corporation is required to change to the principal method(s) of accounting. Furthermore, the regulations provide that a section 481(a) adjustment resulting from an accounting method change in connection with a section 381(a) transaction is calculated as of the beginning of the day that is immediately after the date of distribution or transfer and is reflected in the acquiring corporation's federal income tax return for the taxable year that includes the date of the distribution or transfer. Based on these rules, if the acquiring corporation intends to operate the trades or businesses of the parties to the section 381(a) transaction as an integrated trade or business, but the combination of the businesses will not occur until sometime in the future, it appears that, under the final regulations, the acquiring corporation could be required to change to the principal method(s) of accounting and compute a section 481(a) adjustment, if applicable, in the year of the section 381(a) transaction, even though the books and records of the trades or businesses have not yet been combined.

Moreover, the final regulations do not address what happens if the acquiring corporation ultimately does not integrate the trades or businesses. For example, if such integration does not occur, it is possible that any change to a principal method of accounting made under the regulations (without a Form 3115) in the year of the section 381(a) transaction could be considered an unauthorized method change, which, as noted above, would not have audit protection.

Scope restrictions for subsequent changes

The AICPA believes that the modifications to the scope restrictions described in Rev. Proc. 2012-39 address the majority of the administrative concerns related to changes in method of accounting that are required as a result of a transaction to which section 381(a) applies. However, because the IRS did not modify the scope restriction for prior five-year changes, the AICPA is concerned that taxpayers could be unfairly precluded from using the automatic consent procedures to change a method of accounting within five years of making a required change to a principal method under sections 381(c)(4) and 381(c)(5). The AICPA believes that the prior five-year change scope restriction is appropriate to limit a taxpayer's ability to voluntarily change the same method of accounting within a short period of time. However, the AICPA does not believe it is appropriate to apply the same standard to a taxpayer that is required to change to a principal method of accounting as a result of a transaction to which section 381(a) applies. Specifically, the relevant policy considerations that support limiting a taxpayer's ability to voluntarily change a method of accounting within a short period of time do not exist with respect to changing the same method of accounting subsequent to a change to a principal method of accounting as a result of a transaction to which section 381(a) applies.

Recommendations

Clarification of rules related to integration of trades or businesses

The AICPA believes that the rule in Treas. Reg. § 1.381(c)(4)-1(c)(1) should be modified to provide that a change to the principal method is only required when the trades or businesses of the acquiring corporation and the distributor or transferor are not operated as separate and distinct trades or businesses in the year of the section 381(a) transaction. The AICPA is concerned that the rule as currently drafted creates a potential trap for unwary taxpayers that may overlook the requirement to change methods of accounting in the year of a section 381(a) transaction merely because of an expressed intent to combine the trades or businesses at some point in the future. The AICPA also believes that making such a change would eliminate potential controversy as to the nature of the documentation a taxpayer would be required to maintain as evidence of its intent to integrate the trades or businesses.

Modification of scope restrictions for changes to a principal method

The AICPA believes that the rules of sections 4.02(6) and (7) of Rev. Proc. 2011-14 should be modified to indicate that, for purposes of determining whether a taxpayer has made a change in method of accounting in the prior five years, a change to a principal method required by operation of section 381(c)(4) or 381(c)(5) should not be taken into account. The AICPA

believes that these rules should be modified so that taxpayers required to change to a principal method as a result of a transaction to which section 381(a) applies are not penalized by being prevented from making subsequent changes to the same item using the automatic consent procedures. Thus, the AICPA recommends sections 4.02(6) and 4.02(7)(a), respectively, be amended as follows:

“...For purposes of this section 4.02(6), a change in overall method of accounting does not include the use of an overall method of accounting when computing taxable income for the taxable year that the taxpayer first files a federal income tax return (“adopts an overall method of accounting”), a change in method of accounting imposed by the Service pursuant to Rev. Proc. 2002-18 (or any successor), or a change to the principal method of accounting pursuant to Treas. Reg. §§ 1.381(c)(4)-1(a)(3) or 1.381(c)(5)-1(a)(3)....”

““...For purposes of this section 4.02(7)(a), a change in method of accounting for an item does not include the use of a method of accounting for the first taxable year that the taxpayer accounts for the item (for example, include in income, deduct, or capitalize) to which the method of accounting relates, a change in method of accounting imposed by the Service pursuant to Rev. Proc. 2002-18 (or any successor), or a change to the principal method of accounting pursuant to Treas. Reg. §§ 1.381(c)(4)-1(a)(3) or 1.381(c)(5)-1(a)(3)....”

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We appreciate your consideration of our recommendations and believe they require minor, but important, changes that are necessary to provide clarification to taxpayers. We welcome a further discussion of these issues and our recommendations, and members of the task force are available to meet with government officials in this regard. If you have any questions, please contact Jennifer Kennedy, Chair, AICPA Section 381 Task Force, at (202) 414-1543, or jennifer.kennedy@us.pwc.com; Carol Conjura, Chair, AICPA Tax Methods and Periods Technical Resource Panel, at (202) 533-3040, or cconjura@kpmg.com; or Jason Cha, AICPA Technical Manager, at (202) 434-9231, or jcha@aicpa.org.

Respectfully submitted,



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