August 29, 2018

Mr. Scott Dinwiddie
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Internal Revenue Service
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Mr. John Moriarty
Deputy Associate Chief Counsel
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Re: Tax Implications of FASB Accounting Standards Update No. 2017-07 Compensation – Retirement Benefits (Topic 715)

Dear Messrs. Dinwiddie and Moriarty:

The American Institute of CPAs (AICPA) is pleased to submit comments with respect to the impact of Financial Accounting Standards Board (FASB) Accounting Standards Update (ASU) 2017-07, Compensation – Retirement Benefits (Topic 715), related to the computation of the cost of a taxpayer's inventory for federal income tax purposes.

The AICPA recommends that the Department of the Treasury ("Treasury") and the Internal Revenue Service (IRS) issue guidance providing for an automatic method change for any accounting method change that is necessary to implement the effect of ASU 2017-07 on the costing of inventory for tax purposes. We also recommend that the IRS implement any such accounting method change requests with a cut-off transition rule and waive the five-year restriction on eligibility to use the automatic consent accounting method change procedures.

The AICPA is the world's largest member association representing the accounting profession with more than 431,000 members in 137 countries and territories, and a history of serving the public interest since 1887. 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.

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We appreciate your consideration of these comments and welcome the opportunity to discuss these issues further. If you have any questions, please contact Jennifer Kennedy, Chair, AICPA Tax Methods and Periods Technical Resource Panel, at (703) 918-6951, or jennifer.kennedy@pwc.com; Ogochukwu Anokwute, Senior Manager – AICPA Tax Policy &

Advocacy, at (202) 434-9231, or ogo.anokwute@aicpa-cima.com; or me at (408) 924-3508, or annette.nellen@sjsu.edu.

Sincerely,

Annette Nellen, CPA, CGMA, Esq.
Chair, AICPA Tax Executive Committee

cc: Mr. Christopher Call, Attorney-Advisor, Office of Tax Legislative Counsel, Department of the Treasury
Ms. Ellen Martin, Tax Policy Advisor, Office of Tax Legislative Counsel, Department of the Treasury

AMERICAN INSTITUTE OF CPAs

Comments on the Tax Implications of ASU 2017-07 (Topic 715)

August 29, 2018

I. Financial Reporting Background

In March 2017, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2017-07, Compensation – Retirement Benefits (Topic 715) – Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost. ASU 2017-07 imposes financial statement disclosure requirements with respect to a company's obligation to pay pension and other post-retirement benefits (OPEB) to company employees. ASU 2017-07 also changed the calculation of the amount of a company's pension and OPEB expense included in the cost of inventory or self-constructed property produced by the company.

Prior to the effective date of ASU 2017-07 (annual periods beginning after December 15, 2017), the required Generally Accepted Accounting Principles (GAAP) financial statement treatment of employee pension expense and OPEB liability was to aggregate all of the components of a company's liability to pay these expenses into a single expense account in the company's financial statements. In addition, to the extent the pension expense and OPEB liability related to employee services performed in connection with the production of property (either inventory or fixed assets), the entire amount of the pension and OPEB liability was included in the cost of the property.

ASU 2017-07 changed the GAAP treatment of pension and OPEB expenses starting in 2018. ASU 2017-07 notes that a company's aggregate pension and OPEB liability consists of a number of distinct components, including:

- Service cost (the portion directly attributable to the employee's current-year services; from a tax perspective, this component is usually referred to as current service cost);
- Interest on the employer's obligation to pay the benefits;
- Actual investment return on plan assets;
- Gain or loss on plan assets;
- Amortization of prior service cost or credit; and
- Amortization of transition asset or obligation existing at the time of the original establishment of the obligation.

These distinct components represent the total cost of an employee's services. ASU 2017-07 provides that for GAAP purposes, only the service cost component of the pension expense and OPEB liability with respect to a production employee is capitalized into the cost of the property produced by that employee. The balance of the company's pension expense and OPEB liability is deducted as a period cost. This GAAP treatment represents a significant change from past practice.

II. Tax Reporting Background

For tax purposes, the starting point in the calculation of the cost of a taxpayer's inventory is the cost determined under the taxpayer's GAAP method of accounting. This cost is referred to in the uniform capitalization (UNICAP) regulations under Internal Revenue Code (IRC or "Code") section 263A[1] as the section 471 cost of the taxpayer's inventory.[2] To determine the cost of inventory for tax purposes, the taxpayer is required to add to the section 471 cost of the ending inventory, any additional section 263A costs that are required for inclusion in the cost of inventory for tax purposes.[3]

In addition, a taxpayer must also treat as additional section 263A costs, positive or negative adjustments reported on Schedule M-3, *Net Income (Loss) Reconciliation for Corporations with Total Assets of $10 Million or More*, relating to categories of costs that affect the cost of the inventory. Schedule M-3 adjustments represent the differences between the amounts of particular categories of costs that are taken into account for financial accounting and tax purposes. In the case of a taxpayer's obligation for employee pension and OPEB expenses, the Schedule M-3 adjustment ordinarily reflects the difference between the amount of the liability that is accrued for GAAP purposes and the amount the taxpayer is permitted to take into account for tax purposes (i.e., the amount that is actually contributed to the taxpayer's various retirement benefit plans).

In the case of a taxpayer's liability for pension and OPEB expenses, the UNICAP regulations do not draw any distinction between the service cost component of the taxpayer's liability and the other components of that liability that are identified in ASU 2017-07.[4] Thus, for tax purposes, the entire amount of a taxpayer's liability for pension and OPEB expenses relating to production employees are included in the cost of inventory or fixed assets produced by the taxpayer, to the extent that amount reflects actual payments to the benefit plans that are otherwise deductible for tax purposes.

As a result of ASU 2017-07, starting in 2018, the section 471 costs of a taxpayer's inventory or self-constructed assets will no longer include the taxpayer's total pension and OPEB liability that is accrued for GAAP purposes. Instead, the costs will include only the current service cost component. Accordingly, a taxpayer is required to include a new category in its additional section 263A costs for tax purposes to take into account the amount of the components of a taxpayer's pension and OPEB liability that is excluded from inventory costs for financial reporting purposes under ASU 2017-07.

A change to recharacterize non-current service costs from section 471 costs to additional section 263A costs is considered a change in method of accounting for tax purposes.[5] Accordingly, a taxpayer making this type of cost recharacterization is required to file an accounting method change request for its 2018 taxable year to obtain the IRS's consent to make this accounting

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[1] All references to "section" or "§" are to the Internal Revenue Code of 1986, as amended, and all references to "Treas. Reg. §" and "regulations" are to U.S. Treasury regulations promulgated thereunder.
[2] Treasury Reg. § 1.263A-1(d)(2).
[3] Treasury Reg. §§ 1.263A-1(d)(2) & (3).
[4] Treasury Reg. § 1.263A-1(e)(3)(ii)(C); CCA 200946037.
[5] Treasury Reg. § 1.263A-1(d)(2)(iii).

method change for tax purposes. Section 12.02(1)(b)(iv) of Rev. Proc. 2018-31 specifically provides that a taxpayer making this type of recharacterization is not eligible to file the change under the automatic consent procedures if the taxpayer uses the simplified production method.

III. Recommendations and Analysis

Recommendations

The AICPA recommends that the IRS and Treasury issue guidance providing that taxpayers that change their method of accounting to comply with the implementation of ASU 2017-07 are eligible to file an accounting method change under the automatic consent procedures in Rev. Proc. 2018-31 (or its successor).

The AICPA also recommends that the IRS and Treasury permit taxpayers to implement the accounting method change using a cut-off transition method.

The AICPA further recommends that the IRS and Treasury waive the 5-year prior change restriction on automatic consent accounting method changes for accounting method changes to comply with ASU 2017-07.

Analysis

Section 12.02(1)(b)(iv) of Rev. Proc. 2018-31 provides that an accounting method change to recharacterize section 471 costs as additional section 263A costs under the simplified production method does not qualify for the automatic consent procedures. As a result, a taxpayer changing its method of accounting to comply with the implementation of ASU 2017-07 must file a Form 3115, *Application for Change in Accounting Method*, before the end of its 2018 taxable year under the advance consent procedures in Rev. Proc. 2015-13.

An accounting method change filed to comply with ASU 2017-07 should not require an IRS National Office review. Requiring taxpayers to utilize the advance consent procedures to implement the accounting method change required by ASU 2017-07 will burden both taxpayers and the IRS. Generally, taxpayers will not have the information necessary to calculate the effect of the change in the cost of their inventory until the end of, or after the end of, the 2018 taxable year. However, they must file a Form 3115 prior to the end of the tax year if the accounting method change request is subject to the advance consent procedures. Also, the advance consent procedures will unnecessarily burden the IRS, since it will have to process thousands of Forms 3115 filed to comply with ASU 2017-07 because the change affects most producers of inventory or self-constructed property.

Providing guidance to allow an automatic method change to comply with ASU 2017-07 will relieve taxpayers of both the administrative burden and time constraints that would otherwise result if this type of accounting method change is subject to the advance consent procedures. It will also relieve the IRS National Office of the burden related to processing thousands of Forms 3115 that taxpayers will likely file to comply.

In addition, under Rev. Proc. 2015-13, a taxpayer that files a Form 3115 to implement the accounting method change resulting from the adoption of ASU 2017-07 must compute a section 481(a) adjustment. The calculation of a section 481(a) adjustment in this situation requires a taxpayer to restate its beginning inventory in the year of change to reflect the use of the new method of accounting. The administrative burden of calculating a section 481(a) adjustment is excessive and avoidable if the change is implemented using a cut-off transition approach. This burden is greater for taxpayers using the last-in, first-out (LIFO) inventory method. These taxpayers must revalue all existing LIFO layers as of the beginning of the year of the change as though the new method was in effect in all prior years.[6]

In the case of the adoption of ASU 2017-07, a taxpayer cannot readily redetermine the cost of its beginning inventory using the procedures in ASU 2017-07 because the taxpayer's cost accounting system for taxable years preceding the adoption would not reflect the principles in ASU 2017-07. It is likely that this type of accounting method change would have a relatively small impact on the cost of a taxpayer's inventory. Requiring taxpayers to reconstruct the effect of such a retrospective change in costing procedures is burdensome and unwarranted when considering the relatively small effect on the cost of a taxpayer's inventory.

Finally, even if this type of accounting method change is eligible for the automatic consent procedures, a taxpayer is not eligible to use the automatic consent procedures if they changed their method of accounting under section 263A within the five taxable years preceding the year of change.[7] A waiver of the five-year restriction will enable a taxpayer to use the automatic consent procedures for method changes resulting from the implementation of ASU 2017-07 even if the taxpayer filed a method change under section 263A within five taxable years preceding the year of change.

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[6] Treasury Reg. § 1.263A-7(c)(2).

[7] Revenue Proc. 2015-13.