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## PRODUCT & SERVICE GUIDE

# TCJA Provides Greater Accounting Changes for Businesses

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**Craig Smalley, MST, EA** • Oct. 15, 2018

I have always used the theory that if I am changing the tax type of a business and filing an initial return under that tax type, then I can change the accounting method without asking permission. For instance, let's say I am going from a partnership that is on the cash basis to an S-Corporation. Why couldn't I change the accounting method to accrual? It is the initial return for that tax type. Now under the TCJA it makes my point even stronger. [Rev. Proc. 2018-40](#), has just proven my point. Although the Rev. Proc's intention is get more people to use the cash method of accounting, why couldn't it go the other way?

A business using the accrual method reports income when all events fixing the right to the income have occurred and the amount can be determined with reasonable accuracy. (Reg §1.451-1(a)) The first part of this test (the all events test) is met on the earliest of

1. The date the required performance occurs,
2. The date payment is due, or
3. The date payment is made.

Under the TCJA, for tax years beginning after 2017, the “AFS conformity rule” says that the all events test for recognizing income is met no later than when the income is recognized on the taxpayer’s (1) Applicable Financial Statement (AFS) or (2) other financial statement as specified by IRS.

Alternatively, under IRC §451(c)(1)(B), as amended by the TCJA, an accrual method taxpayer may elect to defer the recognition of all or a portion of an advance payment to the tax year following the tax year in which the payment is received, except any portion of such advance payment that is required under IRC §451(b) to be included in gross income in the tax year in which the payment is received.

IRC §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 tax year of receipt is a permissible accounting method,
2. Any portion of which is included in revenue by the taxpayer in an AFS (or such other financial statement as IRS may specify) for a subsequent tax year, and
3. Which is for goods, services, or such other items as may be identified by IRS. If this election is made, it’s an accounting method that applies to the current and all future years unless the taxpayer gets IRS permission to change it.

To unpack this, let’s say you had an S-Corporation in 2017, and you decided to convert the S-Corporation to a C-Corporation. The S-Corporation was on the cash method of accounting, however, income and expense are clearly shown under the accrual method. You can then change the accounting method without filing Form 3115.

Under the TCJA, for tax years beginning after 2017, taxpayers other than tax shelters can use the cash method if their average annual gross receipts do not exceed \$25 million. IRC §448(c) (This amount will be adjusted for inflation for years after 2018.) This test is based on the 3-tax-year period before the testing year; i.e., it no longer has to be met for all prior tax years. All taxpayers treated as a single employer under IRC §52(a) or IRC§ 52(b), IRC§ 414(m) or IRC §414(o) are treated as a single taxpayer. If a taxpayer hasn’t been in existence for three years, the test period is the number of years the taxpayer has existed. Finally, gross receipts for short tax years must be annualized.

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