



American Institute of CPAs  
1455 Pennsylvania Avenue, NW  
Washington, DC 20004-1081

July 30, 2012

Ms. Lisa Zarlenga  
Tax Legislative Counsel  
Department of the Treasury  
1500 Pennsylvania Avenue, N.W.  
3040 MT  
Washington, D.C. 20220

RE: Comments on the Definition of Issue under Consideration – Certain Foreign Corporations Contained in Rev. Proc. 2011-14, Section 3.09(4) and Rev. Proc. 97-27 Section 3.08(4)

Dear Ms. Zarlenga:

The American Institute of CPAs (AICPA) appreciates the opportunity to provide comments regarding the definition of “issue under consideration” for certain foreign corporations contained in Revenue Procedure 2011-14 and Revenue Procedure 97-27, as amended and modified (collectively, the “Revenue Procedures”). As explained in detail below, the AICPA believes that the definition of “issue under consideration” for certain foreign corporations contained in the Revenue Procedures effectively precludes many United States (U.S.) multinational corporations from voluntarily complying with proper tax accounting principles by filing applications for accounting method changes on behalf of their controlled foreign corporations or 10/50 corporations (collectively “foreign corporations”) either under Revenue Procedure 2011-14 (for an automatic method change) or under Revenue Procedure 97-27 (for a nonautomatic method change).<sup>1</sup> The AICPA further believes that such a restriction (1) forces many multinational corporations to either remain on impermissible methods or make unauthorized method changes; (2) is contrary to the general tax policy underlying the Revenue Procedures – namely, to encourage taxpayers

---

<sup>1</sup> For this purpose, a controlled foreign corporation is defined in sections 953(c)(1)(B) or 957 and a noncontrolled section 902 corporation is defined in section 904(d)(2)(E). See section 5.06 of Rev. Proc. 2011-14.

to voluntarily comply with proper tax accounting principles; and (3) draws distinctions between domestic and foreign corporations in situations where Congress has consistently indicated that they should be treated similarly.

These comments were developed by the Foreign Corporation Method Change Task Force of the AICPA's Tax Methods and Periods Technical Resource Panel, and approved by the AICPA Tax Executive Committee.

As the national professional association of certified public accountants comprised of approximately 377,000 members, the AICPA is well positioned to comment on technical and procedural issues in the Revenue Procedures. Our members consult on methods of accounting and prepare and/or review Forms 3115, *Applications for Change in Accounting Method*, for thousands of domestic and foreign corporations and partnerships. Based on our members' significant experience with filing method changes and consulting on taxpayers' methods of accounting, we offer the following specific comments and suggestions to address what we view as onerous procedural restrictions on certain foreign taxpayers under the Revenue Procedures.

### Background

1. Foreign corporations treated substantially the same as domestic corporations with respect to accounting method principles

Section 964 of the Internal Revenue Code of 1986, as amended (the "Code"), provides that the earnings and profits (E&P) of any foreign corporation, and the deficit in E&P of any foreign corporation, for any taxable year shall be determined according to rules substantially similar to those applicable to domestic corporations, under regulations prescribed by the Secretary. Regulations promulgated under section 964 provide that the E&P of a foreign corporation generally must be computed substantially as if such corporation were a domestic corporation by, for example, making the adjustments necessary to conform to proper tax accounting methods and following the proper procedures for making an election or changing a method of accounting.<sup>2</sup>

However, the regulations under section 964 prescribe that action, by or on behalf of a foreign corporation, to make an election or to adopt a method of accounting is not required until the due date (including extensions) of the return for a controlling domestic shareholder's first taxable year with or within which ends the foreign corporation's first taxable year in which the computation of its E&P is "significant" for U.S. tax purposes with respect to its controlling domestic shareholders.<sup>3</sup> Accordingly, once E&P is significant for U.S. tax purposes, any accounting method

---

<sup>2</sup> Treas. Reg. § 1.964-1(a)(1) and § 1.964-1(c).

<sup>3</sup> Treas. Reg. § 1.964-1(c)(6).

permitted under U.S. tax law can be adopted on behalf of a foreign corporation and, once adopted, that method can be changed only by the controlling domestic shareholder(s) following the proper procedural requirements, including the filing of forms and securing consent of the Commissioner.

2. Method change procedural rules for taxpayers under exam applicable to foreign corporations

In general, consent of the Commissioner is obtained to voluntarily change a method of accounting by filing a Form 3115 pursuant to one of the Revenue Procedures. However, the Revenue Procedures provide that a taxpayer that is under examination is precluded from filing an application to change a method of accounting *unless* the taxpayer (1) is within a 90-day window (as defined below), (2) is within a 120-day window (as defined below), (3) obtains the consent of the director, or (4) foregoes audit protection. Audit protection may be forgone due to (a) the application being a particular change that is not subject to audit protection, (b) the method to be changed being an issue pending for any taxable year under examination, or (c) the method to be changed being an issue under consideration by the appeals office.<sup>4</sup>

Taxpayers under examination that are changing from impermissible methods generally will seek to file their method change applications only within the 90- or 120-day windows for the following reasons. First, obtaining the consent of the director generally is not an option when a taxpayer is changing from an impermissible method because the director likely will choose to incorporate the requested method change into the examination of the taxpayer rather than granting consent for the taxpayer to make a voluntary method change.<sup>5</sup> Second, taxpayers changing from impermissible methods generally seek audit protection to avoid interest and penalties, as well as the additional complexities, arising if the Internal Revenue Service (IRS) raises the same issue as part of an examination of an earlier tax year. Thus, availability of the 90-day and 120-day windows is critical for a taxpayer to voluntarily change from an impermissible method.

Under the 90-day window, a taxpayer, or the designated shareholder of a foreign corporation, may file an application for a change of method of accounting during the first 90 days of any taxable year if it has (or in the case of a foreign corporation, all of its controlling domestic shareholders that are under examination have) been under examination for at least 12 consecutive months as of the first day of the taxable year

---

<sup>4</sup> Revenue Procedure 2011-14, section 6.03; and Revenue Procedure 97-27, section 6.01.

<sup>5</sup> Director consent generally is available only where the director is of the opinion that the method of accounting to be changed would ordinarily not be included as an item of adjustment in the year(s) for which the taxpayer is under examination. For example, the director will consent to the filing of an application to change from a clearly permissible method of accounting, or from an impermissible method of accounting where the impermissible method was adopted subsequent to the years under examination. See Revenue Procedure 2011-14, section 6.03(4); Revenue Procedure 97-27, section 6.01(4).

(the “90-day window”).<sup>6</sup> Similarly, a taxpayer, or the designated shareholder of foreign corporation, may file an application to change a method of accounting during the 120-day period following the date an examination of the taxpayer (or, in the case of a foreign corporation, of each of the controlling domestic shareholders that were under examination) ends, regardless of whether a subsequent examination has commenced (the “120-day window”).<sup>7</sup> However, neither the 90-day window nor the 120-day window is available if the method of accounting that the taxpayer is seeking to change is an “issue under consideration” at the time the taxpayer, or designated shareholder, would otherwise file a copy of the application.<sup>8</sup>

### 3. Issue under consideration standard differs for domestic and foreign corporations

The term “issue under consideration” is narrowly defined for a domestic corporation in section 3.09(1) of Revenue Procedure 2011-14 and section 3.08(1) of Revenue Procedure 97-27. Under both of these sections, a taxpayer's method of accounting for an item is an issue under consideration for the taxable years under examination if the taxpayer receives written notification (for example, by examination plan, information document request (“IDR”), or notification of proposed adjustments or income tax examination changes) from the examining agent(s) “*specifically citing the treatment of the item as an issue under consideration*” (Emphasis added). Both sections provide identical examples of taxpayers' methods of accounting for items being issues under consideration. One example states that a taxpayer's method of pooling under the dollar-value, last-in, first-out (LIFO) inventory method is an issue under consideration as a result of an examination plan that identified LIFO pooling as a matter to be examined. However, the example is explicit that it is *not* an issue under consideration as a result of an examination plan that merely identified LIFO inventories as a matter to be examined. Similarly, another example provides that a taxpayer's method of determining inventoriable costs under section 263A is an issue under consideration as a result of an IDR that requests documentation supporting the costs included in inventoriable costs, but is *not* an issue under consideration as a result of an IDR that requests documentation supporting the amount of costs of goods sold reported on the return. Both of these sections also state that the question of whether a method of accounting is an issue under consideration may be referred to the national office as a request for technical advice.

Notwithstanding the *narrow* definition of an issue under consideration applicable generally under section 3.09(1) and section 3.08(1) of the Revenue Procedures, section 3.09(4) of Revenue Procedure 2011-14 and section 3.08(4) of Revenue Procedure 97-27, as amended by Revenue Procedure 2009-39, provide a special rule for foreign corporations. Under the special rule, a foreign corporation's method of accounting for

---

<sup>6</sup> Revenue Procedure 2011-14, section 6.03(2); Revenue Procedure 97-27, section 6.01(2).

<sup>7</sup> Revenue Procedure 2011-14, section 6.03(3); Revenue Procedure 97-27, section 6.01(2) and (3).

<sup>8</sup> Revenue Procedure 2011-14, section 6.03(2) and (3); Revenue Procedure 97-27, section 6.01(2) and (3).

an item is an issue under consideration if any of the corporation's controlling domestic shareholders receives notification (i.e., by examination plan, IDR, notice of proposed adjustment or income tax examination changes) that “*the treatment of a distribution or deemed distribution from the foreign corporation, or the amount of its earnings and profits, or foreign taxes deemed paid, is an issue under consideration.*” (Emphasis added.) Thus, under this broad definition, *all* of the methods of accounting used to compute E&P would be under consideration if the controlling domestic shareholder(s) has received notice that the earnings and profits of the foreign corporation is an issue under consideration, which is the equivalent to treating all the methods of a domestic corporation as being under consideration if the taxpayer receives notification that the IRS is auditing taxable income.

#### AICPA Position

As explained in more detail below, the AICPA is concerned that the extremely broad definition of “issue under consideration” (IUC) for certain foreign corporations contained in the Revenue Procedures effectively precludes many U.S. multinational corporations from voluntarily complying with proper tax accounting principles and, as a result, (1) forces these corporations to either remain on impermissible methods or make unauthorized method changes; (2) is contrary to the general tax policy underlying the Revenue Procedures – namely, to encourage taxpayers to voluntarily comply with proper tax accounting principles; and (3) draws distinctions between domestic and foreign corporations in situations where Congress has consistently indicated that they should be treated similarly.

1. Broad definition of IUC forces foreign corporation to remain on impermissible methods or make unauthorized method changes

The AICPA respectfully submits that in many examinations of U.S. multinational corporations, a taxpayer is notified in an examination plan or in an initial-round IDR that the amount of the E&P, or deemed paid taxes, of its foreign corporations is an issue under consideration. Indeed, our experience is consistent with the Internal Revenue Manual (the “Manual”) provisions related to examinations of controlled foreign corporations (CFCs). Section 4.61.7.39 of the Manual provides that “[t]he proper determination of earnings and profits is *vital* in the examination of a CFC” (Emphasis added). Further, Section 4.61.7.40 of the Manual provides E&P guidelines, the first of which is: “[d]etermine that the proper books and records were used to compute the profit and loss statement from which the determination of earnings and profits was calculated.” Given such guidance in the Manual for the examination process of a CFC, it is difficult to imagine an examination where the controlling domestic shareholder would not be notified early in the process that the E&P of its foreign corporations was an issue under consideration. Thus, in the examination of many U.S. multinational corporations, a 90-day window is

unavailable because all of the foreign corporation's methods are considered under consideration. Moreover, because these U.S. multinationals often have overlapping examination cycles, a 120-day window also might not be available even after an examination cycle ends because E&P is likely still an issue under consideration in another open cycle.

2. Broad definition of IUC is contrary to tax policy underlying voluntary method change procedures

As a result of the significant restrictions on the ability to use the 90- and 120-day window periods, the AICPA submits that the definition of the term “issue under consideration” for foreign corporations contained in the Revenue Procedures prevents voluntary compliance with proper accounting methods. For a foreign corporation that is not seeking to change from one permissible method to another permissible method, or to change from an impermissible method to a permissible method where the impermissible method was adopted subsequent to the years under examination (in which cases it could obtain director consent), the limited availability of the 90- or 120-day window essentially precludes it from changing to a permissible method and obtaining audit protection. As a consequence, such corporations are forced to either remain on their impermissible methods of accounting or to change without consent of the Commissioner (thereby forgoing audit protection). Neither option is in the best of interest of sound tax administration.

3. Broad definition of IUC is inconsistent with Congressional intent to treat foreign corporations substantially similar to domestic corporations

Moreover, this result is contrary to the tax policy behind the Revenue Procedures, which is to encourage voluntary compliance by providing favorable terms and conditions for a taxpayer-initiated method change. Indeed, section 1.02 of Revenue Procedure 97-27 is explicit that it provides “incentives to encourage prompt voluntary compliance with proper tax accounting principles,” presumably because voluntary compliance generally is accepted as the most efficient manner of administering the tax law. Thus, the Revenue Procedures provide incentives for voluntary compliance including a choice of permissible methods, a current year of change, a four-year spread of an unfavorable section 481(a) adjustment, and, in most cases, audit protection preventing the IRS from raising the same issue in an earlier taxable year. These incentives contrast sharply with the consequences of a change made as part of an examination. With an IRS-initiated method change, the IRS changes to a method that in *its* opinion clearly reflects income, makes the change effective for the *earliest* taxable year under examination, and imposes a *one-year* spread for the unfavorable section 481(a) adjustment. The AICPA believes the broad definition of issue under consideration for foreign corporations is inconsistent with tax policy underlying the Revenue Procedures of providing incentives for voluntary compliance because

foreign corporations under examination are often precluded from using the window periods to voluntarily change from an impermissible method.

Finally, the AICPA believes that the definition of issue under consideration for foreign corporations also is inconsistent with Congressional intent, as expressed in section 964 as well as the regulations promulgated thereunder. These provisions reflect an intent to treat foreign corporations in a manner substantially similar to domestic corporations in respect of accounting methods for E&P. Under section 964, E&P and any deficit in E&P of a foreign corporation is to be determined under rules “substantially similar” to those applicable to domestic corporations. The Regulations promulgated under section 964 require that the methods of accounting for E&P of a foreign corporation reflect the provisions of section 446 of the Code. Thus, foreign corporations are subject generally to the accounting methods procedural rules applicable to domestic corporations. The AICPA believes that the special procedural rule for determining when an issue is under consideration applicable to foreign corporations, which starkly contrasts with the rule applicable to domestic corporations, is inconsistent with this intent.

#### AICPA Recommendation

As indicated above, the AICPA believes that the Revenue Procedures' broad definition of an issue under consideration for foreign corporations is inappropriate and effectively precludes many U.S. multinational corporations from voluntarily complying with proper tax accounting principles. As a result, the AICPA recommends that section 3.09(4) of Rev. Proc. 2011-14 and section 3.08(4) of Rev. Proc. 97-27 be deleted from the Revenue Procedures. Instead, we recommend that the definitions applicable to domestic corporations in sections 3.09(1) of Revenue Procedure 2011-14 and 3.08(1) of Revenue Procedure 97-27 apply to *all* taxpayers, *including foreign corporations*.

The AICPA also recommends that a third example be provided in these sections contrasting when an item is an issue under consideration for a foreign corporation and when it is not an issue under consideration in a manner similar to the two examples already in these sections. For example, the AICPA suggests an example providing that a foreign corporation's depreciation method is an issue under consideration as a result of an IDR that requests documentation supporting a calculation of depreciation for purposes of computing the corporation's E&P, but is not an issue under consideration as a result of an IDR that requests the computation of the corporation's E&P.

We understand that the rationale for the broad definition of “issue under consideration” resulted from the examination practice of issuing general IDRs to audit the E&P of a foreign corporation as opposed to specific IDRs citing specific methods to be examined. Rather than frustrating voluntary compliance for foreign corporations, the

Ms. Lisa Zarlenga

July 30, 2012

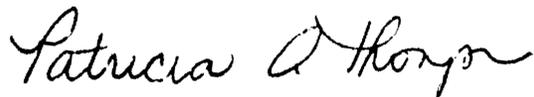
Page 8 of 9

AICPA submits that the more efficient administration of the tax law would be to allow and encourage voluntary compliance with proper tax accounting principles by aligning the “issue under consideration” definition for foreign corporations with its definition for domestic corporations. Then, to address the concern that no issues would be under consideration for a foreign corporation, we would suggest changing the examination practice of sending general examination plans and IDRs indicating that E&P will be reviewed during the examination. Instead, examining agents could be trained to conduct examinations of foreign corporations' E&P in a manner comparable to the examinations of domestic corporations' taxable income, that is, with narrowly targeted examination plans and IDRs. If this were the examination practice, then there would be no all-encompassing examination plans and IDRs that would render every accounting method issue that could be raised in respect of E&P of a foreign corporation an “issue under consideration.” Rather, only those foreign corporations that had specifically identified items being examined in respect of their E&P would appropriately be precluded from utilizing the 90- or 120-day windows for method changes related to such items, consistent with the treatment of domestic corporations.

\* \* \* \* \*

We appreciate your consideration of these comments. If you have any questions regarding this submission, please feel free to contact Christine Turgeon, Chair of the AICPA Foreign Corporation Method Change Task Force, at (656) 471-1660, or [christine.turgeon@us.pwc.com](mailto:christine.turgeon@us.pwc.com); Carol Conjura, Chair, AICPA Tax Methods and Periods Technical Resource Panel, at (202) 533-3040, or [cconjura@kpmg.com](mailto:cconjura@kpmg.com); or Michelle R. Koroghlanian, AICPA Technical Manager, at (202) 434-9268, or [mkoroghlanian@aicpa.org](mailto:mkoroghlanian@aicpa.org).

Respectfully submitted,



Patricia A. Thompson, CPA  
Chair, AICPA Tax Executive Committee

cc: Scott Mackay, Taxation Specialist, Department of the Treasury, Office of Tax Legislative Counsel  
Alexa Claybon, Attorney-Advisor, Department of the Treasury, Office of Tax Legislative Counsel  
Michael Caballero, International Tax Counsel, Department of the Treasury  
William J. Wilkins, Chief Counsel, Internal Revenue Service

Ms. Lisa Zarlenga

July 30, 2012

Page 9 of 9

Andrew Keyso, Jr., Associate Chief Counsel (Income Tax & Accounting), Internal Revenue Service

Steven Musher, Associate Chief Counsel (International), Internal Revenue Service

Heather Maloy, Commissioner, Large Business and International Division, Internal Revenue Service