October 20, 2014

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

Re: Comments on Final Regulations on Corporate Estimated Taxes under Section 6655 of the Internal Revenue Code (T.D. 9347)

Dear Mr. Keyso:

The American Institute of Certified Public Accountants (AICPA) appreciates the opportunity to submit comments on the final regulations under section 6655 of Internal Revenue Code.¹ These comments were developed by the Estimated Taxes 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 member association representing the accounting profession, with more than 400,000 members in 128 countries and a history of serving the public interest since 1877. 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.

We have identified a variety of key issues in the application of the final regulations under section 6655. We respectfully request the Internal Revenue Service and Department of the Treasury modify the final regulations to address these issues with our suggestions below to prevent further controversy.

* * * * *

We appreciate your consideration of our recommendations and we welcome further discussion. If you have any questions, I can be reached at (304) 522-2553, or jporter@portercpa.com; or you may contact Jennifer Kennedy, Chair, AICPA Estimated Taxes Task Force, at (202) 414-1543, or jennifer.kennedy@us.pwc.com; Carol Conjura, Chair, AICPA Tax Methods and Periods

¹ All references herein to “section” or “§” are to the Internal Revenue Code of 1986, as amended, or the Treasury Regulations promulgated thereunder.
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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,

Jeffrey A. Porter, CPA
Chair, Tax Executive Committee

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AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

Comments on Final Regulations under Section 6655 regarding Corporate Estimated Taxes

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October 20, 2014
Comments on Final Regulations under Section 6655 regarding Corporate Estimated Taxes

I. Scope of Comments

On August 6, 2007, the Internal Revenue Service (IRS) and Department of the Treasury ("Treasury") released final regulations under section 6655 of the Internal Revenue Code (IRC) relating to corporate estimated tax. The final regulations provide guidance to corporations with estimated tax requirements. Our comments below, which are primarily related to the determination of annualized taxable income, appear in the same general order as the related provisions in the final regulations.

In addition, we have identified other concerns with the final regulations which would require regulatory action to address. The scope of this letter relates only to those areas which the IRS and Treasury may address under the authority to publish guidance provided by Treas. Reg. §§ 1.6655-2(f) and 1.6655-2(g).

II. Executive Summary

The AICPA applauds the IRS and Treasury for providing comprehensive rules that provide greater clarity to taxpayers with respect to a number of issues related to the computation of corporate estimated tax payments. To provide additional clarity, we recommend that the IRS and Treasury exercise the authority under Treas. Reg. § 1.6655-2(f) to publish guidance in the Internal Revenue Bulletin to address items detailed below.

A. General Rule

The AICPA suggests the IRS and Treasury clarify that annual limitations are treated as discrete items triggered in the annualization period in which the limitation is first exceeded on a pre-annualization basis to clarify the treatment of certain items where the general rules for determining annualized taxable income create potential distortions.

B. Reasonably Accurate Allocation Rule

The AICPA recommends the IRS and Treasury add deductions of amounts to related foreign persons under section 267(a)(3) and deductions under section 83 to the list of items described in Treas. Reg. § 1.6655-(f)(2) (i.e., amounts required to be allocated in a reasonably accurate manner).

C. Extraordinary Items

The AICPA recommends the IRS and Treasury add capital loss and charitable contribution carryovers and accelerated advance payments to the list of extraordinary items in Treas. Reg.

D. Distributive Share of Credits from Passthrough Entities

The AICPA recommends the IRS and Treasury issue examples to clarify whether credits passed through from partnerships are subject to the current year credit rules under Treas. Reg. § 1.6655-2(f)(3)(iii).

E. Items that Substantially Affect Taxable Income but Cannot be Determined Accurately by the Installment Due Date

The AICPA recommends the IRS and Treasury expand on the example provided in the regulations to further illustrate methodologies that are acceptable to reasonably estimate the items identified in Treas. Reg. § 1.6655-2(g)(1). In addition, the AICPA recommends adding the research credit to the list of items that substantially affect taxable income but cannot be determined accurately by the installment due date.

F. Advance Payments

The AICPA recommends the IRS and Treasury clarify that advance payments that are deferred under Rev. Proc. 2004-34 and substantial advance payments that are deferred under Treas. Reg. § 1.451-5(c) are recognized for each installment period using the same basis as is used to compute the amount of income recognized in the year of receipt.

III. AICPA Specific Comments

A. General Rule

The general rule as provided in the regulations\(^2\) requires taxpayers to determine taxable income for the annualization period by taking into account all items of income, deduction, and loss that would properly be taken into account by the last day of the annualization period but only to the extent such items are properly taken into account in determining the taxpayer’s taxable income for the taxable year that includes the annualization period. Thus, the general rule essentially treats the annualization period as a short taxable year. Once the annualization period income is calculated, it is annualized to estimate the full year’s taxable income and used to calculate the installment payment due.

The IRS and Treasury recognize that in certain situations the application of the general rule may create a distortion in the estimate of annualized taxable income. As a result, the regulations adopted several special rules applicable only to specific items determined to fall within the purview of these rules. These special rules, however, do not consider how annual limitations are applied when determining annualized taxable income.

For example, section 162(m) limits the allowable deduction for certain “covered employees” (such as corporate officers) of publicly traded corporations to $1,000,000 for each taxable year.

\(^2\) Treasury Reg. § 1.6655-2(f)(1).
Due to the often uncertain or contingent nature of corporate officer compensation, it is conceivable that at the time each required installment payment is due, the taxpayer may not know whether a particular officer’s cumulative compensation will exceed $1,000,000 for the taxable year. Therefore, in the case of a covered employee’s compensation that has not exceeded $1,000,000 by the end of an annualization period but may exceed it for the full taxable year, it is difficult to determine the disallowed amount of the final compensation pursuant to section 162(m) for purposes of determining annualized taxable income.

With respect to such annual limitations, the AICPA recommends guidance treating such annual limitations as discrete items triggered in the annualization period in which the limitation threshold is first exceeded on a pre-annualization basis. For example, in the case of the section 162(m) limitations discussed above, if a covered employee earned $1,200,000 through the end of an annualization period, then no compensation deductions for that covered employee in excess of $1,000,000 would be considered in determining current annualization period income and all subsequent annualization period income for the remainder of the year.

B. Reasonably Accurate Allocation Rule

Treasury Reg. § 1.6655-2(f)(2) provides a listing of deductions that are required to be allocated “in a reasonably accurate manner,” ostensibly to provide taxpayers with guidance as to the treatment of items of deduction that are routinely incurred on an annual basis or for which special exceptions to the general accounting rules exist. The regulations provide that the reasonably accurate allocation rule applies to the following deductions:

1. Real property tax deductions;
2. Employee and independent contractor deductions;
3. Deductions under sections 404 and 419;
4. Deductions for corporate accrual charitable donations (section 170(a)(2)), the recurring item exception (Treas. Reg. § 1.461-5), and the 12-month rule (Treas. Reg. § 1.263(a)-4(f)); and
5. Items of deduction designated by the Secretary in the Internal Revenue Bulletin.

As justification for adopting the reasonably accurate allocation rule, the preamble to the final regulations observes “(g)iven the nature of these items, applying the general annualization rules to these items could result in a significant distortion in the estimate of annualized taxable income.”

The AICPA has identified some common situations that fall outside the purview of this rule but where the continued application of the general rule may result in a distortion. Therefore, we suggest adding these items to the list of items subject to the reasonably accurate allocation rule. Treasury Reg. § 1.6655-2(f)(2)(i)(E) provides Treasury with the authority to designate additional items of deductions as being governed under the reasonably accurate allocation special rule.
**Deduction of Amounts Owed to a Related Foreign Person**

Except as provided in Treas. Reg. § 1.267(a)-3(c), section 267(a)(3) requires a taxpayer to use the cash method of accounting with respect to the deduction of amounts owed to a related foreign person (e.g., interest). Interest and other expenses owed to a related foreign person are commonly paid at or near year end. Thus, the general rule under Treas. Reg. § 1.6655-2(f)(1) precludes the taxpayer from considering such deductions for purposes of determining quarterly estimated tax installment payments. In other words, the continued application of the general rule to these items effectively forces taxpayers to overpay quarterly estimated tax installments under the annualization method. In order to mitigate this distortion, the AICPA suggests adding deductions under section 267(a)(3) to the list of items subject to the reasonably accurate allocation rule.

**Treatment of Section 83 Property for Services**

As noted above, deductions for non-qualified stock options and restricted stock under section 83 are not listed as one of the deductions subject to the reasonably accurate allocation rule. Thus, these compensation deductions are subject to the general rule rather than the reasonably accurate allocation special rule. The continued application of the general rule with respect to compensation deductions upon the exercise of non-qualified stock options and restricted stock may cause a distortion in the determination of estimated annualized taxable income. Therefore, the AICPA suggests adding deductions under section 83 (property transferred in connection with the performance of services) to the list of items subject to the reasonably accurate allocation special rule.

**C. Extraordinary Items**

Treasury Reg. § 1.6655-2(f)(3)(ii) contains a list of extraordinary items that a taxpayer must take into account after annualizing taxable income for the annualization period. The AICPA generally agrees with the list of items included in Treas. Reg. § 1.6655-2(f)(3)(ii), which would prevent potential distortion in the computation of annualized taxable income. To further the objective, we suggest adding the following items to the list.

**Capital Losses and Charitable Contribution Carryovers**

Treasury Reg. § 1.6655-2(f)(3)(ii)(C) provides that in calculating annualized taxable income, a taxpayer would treat net operating loss deductions as extraordinary items occurring on the first day of the annualization period to which they are attributed. However, the treatment of similar deductions such as capital loss and charitable contribution carryovers are not specifically provided in the regulations. To clarify this issue, the AICPA suggests adding capital loss and charitable contribution carryovers to the list of extraordinary items in Treas. Reg. § 1.6655-2(f)(3)(ii).
**Accelerated Advance Payments**

Generally, an advance payment is included in taxable income in the year received. However, various exceptions to this general rule exist. For example, Treas. Reg. § 1.451-5 allows the inclusion of advance payments received in connection with the sale of goods in income under a company’s normal method of accounting, provided the income is not reported any later than in the year in which such income is reported for financial statement purposes. Exceptions to this deferral treatment may apply, including if the taxpayer’s liability with respect to the advance payment ceases to exist (see Treas. Reg. § 1.451-5(f)). In such a case, the taxpayer must include in gross income any portion of the advance payment not recognized in a previous tax year. Treasury Reg. § 1.455-4 and section 5.02(5) of Rev. Proc. 2004-34 provide very similar acceleration rules.

A taxpayer must take into account any advance payment that requires such acceleration under the general rules described in Treas. Reg. § 1.6655-2(f)(1)(i) when determining taxable income for the annualization period. Thus, the acceleration would result in the taxpayer’s annualized taxable income being distorted.

For example, assume a calendar year taxpayer making estimated tax payments per Treas. Reg. § 1.6655-2(b)(1) (i.e., the four installments are computed based on the first three, three, six, and nine months of the taxpayer’s taxable year, respectively) receives an advance payment of $240 on January 1, 2012 for a two-year service contract terminating on December 31, 2013. For financial statement purposes, the taxpayer will recognize the advance payment ratably over the two-year period. Thus, the taxpayer will recognize $120 of the advance payment during 2012 and the remaining $120 during 2013 under the provisions of Rev. Proc. 2004-34. The taxpayer’s liability with respect to the advance payment ceases to exist on June 15, 2012. As a result, the taxpayer must recognize the remaining portion of the advance payment (i.e., $190) as taxable income. Subsequently, when the taxpayer calculates the third installment of estimated taxes, which is based on the first six months of the taxable year, the full $240 advance payment is annualized by multiplying by a factor of 2, resulting in estimated taxable income of $480.

To remove this potential distortion, the AICPA recommends adding advance payments that are recognized in gross income in an accelerated manner due to a triggering event to the list of extraordinary items in Treas. Reg. § 1.6655-2(f)(3)(ii).

D. Distributive Share of Credits from Passthrough Entities

The distributive share rules require that a partner must determine its taxable income for the annualization period by taking into account its distributive share of partnership items under section 702, which includes credits. Currently, the regulations do not specifically indicate whether credits reported from partnerships should be annualized, or whether, under the special rule for current year credits under Treas. Reg. § 1.6655-2(f)(3)(iii), the partner should take into account its distributive share of the items which make up the credit, then annualize these items in order to determine the amount of credit to take into account. To clarify this issue, the AICPA recommends that the IRS and Treasury publish guidance stating that credits passed through from partnerships are subject to the current year credits rule under Treas. Reg. § 1.6655-2(f)(3)(iii).
E. Items that Substantially Affect Taxable Income but Cannot be Determined Accurately by the Installment Due Date

Treasury Reg. § 1.6655-2(g)(1) provides that “reasonable estimates may be made from existing data for items that substantially affect income if the amount of such items cannot be determined accurately by the installment due date.” The regulations provide that reasonable estimates are permitted for the following deductions:

1. The inflation index for taxpayers using the dollar-value LIFO (last-in, first-out) inventory method;
2. Adjustments required under section 263A;
3. The computation of a taxpayer’s section 199 deduction;
4. Intercompany adjustments for taxpayers that file consolidated returns;
5. The liquidation of a LIFO layer at the installment date that the taxpayer reasonably believes will be replaced at the end of the year;
6. Deferred gain on a qualifying conversion or exchange of property under sections 1031 and 1033 that the taxpayer reasonably believes will be replaced with qualifying replacement property; and
7. Any other item specifically designated in guidance published in the Internal Revenue Bulletin.

Currently, the regulations provide only one example to illustrate a methodology of a reasonable estimate for deduction under section 199. While the example is instructive for taxpayers claiming a deduction under section 199, it is only one out of six specifically identified items to which Treas. Reg. § 1.6655-2(g)(1) applies.

Moreover, the example does not clearly indicate whether estimating the annual effect of an item and allocating the item ratably throughout the year in a manner similar to the treatment of an extraordinary item is acceptable. For example, certain methods under section 263A (e.g., the simplified production method) are annual computations that, unlike section 199, are not limited by taxable income or other limitations; such adjustments are easily identifiable when estimating taxable income for a given installment period.

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Example. Section 199 deduction. Corporation ABC, a calendar year taxpayer, uses an accrual method of accounting and the annualized income installment method under section 6655(e)(2)(A)(i) to calculate all of its required installment payments for its 2008 taxable year. ABC engages in production activities that generate qualified production activities income (QPAI), as defined in § 1.199-1(c), and projects taxable income of $50,000 for its first annualization period from January 1, 2008, through March 31, 2008, without taking into account the section 199 deduction. During its first annualization period from January 1, 2008, through March 31, 2008, ABC incurs W-2 wages allocable to domestic production gross receipts pursuant to section 199(b)(2) of $10,000. Pursuant to paragraph (g)(1) of this section, ABC is permitted to take into account its estimated section 199 deduction before annualizing taxable income based on the lesser of its estimated QPAI or taxable income and W-2 wages for its first installment period for 2008. For the first installment period in 2008, ABC is permitted to recognize a deduction under section 199 of $3,000 ($50,000 x .06 = $3,000) subject to the wage limitation of $5,000 (50 percent of $10,000 of W-2 wages incurred during the first installment period). Accordingly, ABC’s annualized income for the first installment for 2008 is $188,000 (($50,000 - $3,000) x 12/3 = $188,000). The tax on $188,000 is $56,570 and ABC’s first required installment for 2008 is $14,143 ($56,570 x .25 = $14,143).
Therefore, the AICPA recommends adding additional examples to further illustrate methodologies that are acceptable to reasonably estimate the items identified in Treas. Reg. § 1.6655-2(g)(1). The AICPA believes that issuing guidance in the form of a Notice with a series of questions and answers is an appropriate format to offer additional examples of acceptable methodologies.

To assist in this effort, we offer two examples below to clarify a taxpayer’s ability to estimate the annual effect of certain items and then allocate the item ratably throughout the year for purposes of determining a reasonable estimate for the installment period.

Adjustments required under section 263A. Corporation ABC, a calendar year taxpayer, uses an accrual method of accounting and the annualized income installment method under section 6655(e)(2)(A)(i) to calculate all of its required installment payments for its 2012 taxable year. ABC uses the FIFO (first-in, first-out) method of accounting for inventories and allocated additional section 263A costs to ending inventory using the simplified production method. Prior to determining its additional section 263A costs, ABC projects taxable income of $3,000,000 for its first annualization period from January 1, 2013, through March 31, 2013. For its 2013 taxable year, ABC estimates that the additional section 263A costs required to be capitalized to ending inventory would increase by $100,000 compared to the amount of additional section 263A costs capitalized to ending inventory for its 2012 taxable year. Pursuant to paragraph (g)(1) of this section, ABC is permitted to take into account its estimated adjustment under section 263A before annualizing taxable income for its first installment period. For purposes of determining its taxable income for the period January 1, 2013, through March 31, 2013, it is reasonable for ABC to estimate that $25,000 of additional section 263A costs are required to be capitalized for the first installment period ($100,000 x 3/12 = $25,000). Accordingly, ABC’s annualized income for the first installment for 2013 is $12,100,000 (($3,000,000 + $25,000) x 12/3 = $12,100,000). The tax on $12,100,000 is $4,135,000, and ABC’s first required installment for 2013 is $1,033,750 ($4,135,000 x .25 = $1,033,750).

Inflation index for taxpayers using the dollar-value LIFO inventory method. Corporation ABC, a calendar year taxpayer, uses an accrual method of accounting and the annualized income installment method under section 6655(e)(2)(A)(i) to calculate all of its required installment payments for its 2012 taxable year. ABC uses the dollar-value LIFO method of accounting for inventories. ABC projects taxable income of $5,000,000 prior to taking into account its LIFO expense for its first annualization period from January 1, 2013, through March 31, 2013. For its 2013 taxable year, ABC estimates its LIFO expense under its dollar-value LIFO inventory method to be $2,000,000 based on an estimate of the quantity and value of its inventory as of the end of the taxable year, and an estimate of inflation for the entire year. Pursuant to paragraph (g)(1) of this section, because ABC uses the dollar-value LIFO inventory method, it is permitted to estimate the inflation index before annualizing taxable income for its first installment period. For purposes of determining its taxable income for the period January 1, 2013, through March 31, 2013, it is reasonable for ABC to estimate that $500,000 of LIFO expense is attributable to the first installment period ($2,000,000 x 3/12 = $500,000). Accordingly, ABC’s annualized income for the first installment for 2013 is $18,000,000 (($5,000,000 - $500,000) x 12/3 = $18,000,000).
tax on $18,000,000 is $6,300,000, and ABC’s first required installment for 2013 is $1,575,000 ($6,300,000 x .25 = $1,575,000).

Treatment of Research and Development Credit

Currently, the treatment of the research and development tax credit (“research credit”) under section 41 is not specifically addressed in the regulations.

The treatment of the research credit imposes a difficulty because many taxpayers lack the means to make all the determinations relevant to computation of the research credit for the relevant annualization period in which the research expenses are incurred. For example, a taxpayer needs to determine not only whether activities are qualified research but whether the amounts paid or incurred for those activities are qualified research expenditures. In addition, since 2007, there has been an alternative, elective method of computing the research credit under section 41(c)(5), referred to as the Alternative Simplified Credit. This method requires the taxpayer to know its qualified research expenses for the current tax year and the three preceding tax years. Unfortunately, many taxpayers often need the full time allowed to file a tax return on extension (or even longer) to accurately determine their qualified research expenses and the research credit. Taxpayers using the Alternative Simplified Credit may not have the information about their preceding year’s qualified research expenses until close to the time for making their third installment payment for the current year or reliable information about current year expenses.

For these reasons, the AICPA recommends adding the research credit to the list of items in Treas. Reg. § 1.6655-2(g) that cannot be determined accurately by the installment due date, for which reasonable estimates are permitted in computing the required installment. We believe that the research credit presents computational and qualitative determinations that are equally complex as the items on the current list (e.g., section 199 deduction).

F. Advance Payments

Treasury Reg. § 1.6655-2(f)(1)(i) provides that in determining the applicable income for an annualization period, an item of income is “includible under the method of accounting employed by the taxpayer with respect to the item and in accordance with the appropriate provision of the IRC (for example, section 451 for accrual method taxpayers, section 453 for installment sales or section 460 for long-term contracts).” With respect to a taxpayer that defers revenue either under Rev. Proc. 2004-34 or Treas. Reg. § 1.451-5(c), Treas. Reg. § 1.6655-2(f)(3)(i) provides special rules for computing taxable income for an annualization period. Specifically, with respect to advance payments under Treas. Reg. § 1.451-5(c), Treas. Reg. § 1.6655-2(f)(3)(i)(A) provides:

An advance payment for which the taxpayer uses the method of accounting provided in § 1.451-5(b)(1)(ii) is includible in computing taxable income for an annualization period in accordance with that method of accounting except that, if § 1.451-5(c) applies, any amount not included in computing taxable income by the end of the second taxable year following the year in which substantial advance payments are received, and not previously included in accordance with the taxpayer’s accrual method of accounting, is includible in computing taxable income on the last day of such second taxable year.

An advance payment for which the taxpayer uses the Deferral Method provided in section 5.02 of Rev. Proc. 2004-34 (2004-1 CB 991), (see § 601.601(d)(2)(ii)(b) of this chapter) is includible in computing taxable income for an annualization period in accordance with that method of accounting, except that any amount not included in computing taxable income by the end of the taxable year succeeding the taxable year of receipt is includible in computing taxable income on the last day of such succeeding taxable year.

Accordingly, any remaining portion of income deferred for financial statement purposes beyond one year in the case of Rev. Proc. 2004-34 or two years in the case of substantial advance payments under Treas. Reg. § 1.451-5(c) should be taken into account in full at the end of the inclusion year in determining annualized taxable income for the year. Treasury Reg. § 1.6655-2(f)(3)(vii) Example 9 illustrates these rules.


(ii) Pursuant to paragraph (f)(3)(i)(B) of this section, ABC is not required to take into account any of the advance payment for purposes of computing any required installment payment for ABC’s 2008 taxable year because no part of the $2,400 advance payment was recognized as income in ABC’s financial statements during the first nine months of ABC’s 2008 taxable year. In 2009, ABC must take into account $300 of revenue for purposes of computing its first and second required installment payments, $600 of revenue for purposes of computing its third required installment payment and $900 for purposes of computing its fourth required installment payment. Pursuant to paragraph (f)(3)(i)(B) of this section, the remaining deferred revenue is recognized on December 31, 2009, for purposes of computing ABC’s annualized income installments for 2009.

We commend the IRS and Treasury on clarifying when income that is deferred for financial statement purposes beyond the limited time permitted for tax purposes should be taken into account in determining annualized taxable income. However, to the extent services or goods are
not provided during the year subsequent to the year of receipt in the case of advance payments deferred under Rev. Proc. 2004-34 (i.e., “Year 2”) (or “Year 3” in the case of advance payments that are deferred under Treas. Reg. § 1.451-5(c)) and a taxpayer continues to defer the revenue for financial statement purposes, it is unclear how the taxpayer should determine its annualized taxable income. Thus, the AICPA recommends further clarifying that income should be recognized for each installment period in Year 2 (or Year 3, for amount deferred under Treas. Reg. § 1.451-5(c)) using the same basis used to compute the amount of income recognized in the year of receipt.