Office of Chief Counsel
Internal Revenue Service
memorandum

Number: **201151022**
Release Date: 12/23/2011

CC:ITA:B01:CHKim
PRESP-138859-11

UILC: 451.13-00

date: December 01, 2011

to: Philip J. Whitworth
Technical Advisor, Group 12
(Large Business and International)

from: John P. Moriarty
Chief, Branch 1
(Income Tax & Accounting)

---

subject: Multiple Deliverable Contracts

This responds to request for assistance asking (1) whether a taxpayer that previously elected to defer advance payments under Rev. Proc. 2004-34, 2004-1 C.B. 991, is required to obtain consent under § 446(e) of the Internal Revenue Code if the taxpayer adopts ASU 2009-13 or ASU 2009-14 and wants to use this new financial statement method in determining the extent to which advance payments are included in gross income under Rev. Proc. 2004-34, and (2) if so, whether consent for this change in method of accounting is obtained by following the automatic consent procedures of Rev. Proc. 2011-14, 2011-4 I.R.B. 330 (January 24, 2011). For the reasons described below, we conclude that the taxpayer (1) must obtain consent under § 446(e) and (2) obtains consent by following the automatic consent procedures of Rev. Proc. 2011-14. Please call Charles Kim at 202-622-5020 if you have any questions.

FACTS

The taxpayer provides goods, services and other applicable items under an agreement known as a Multiple Deliverable Contract (MDC) which requires the taxpayer to provide bundled products and services to customers. The goods and services are provided at different points in time and over different time periods. The taxpayer receives advance payments for these goods and services. For financial statement purposes, the taxpayer presently properly defers the advance payments until the MDC is fully complete (i.e., until all goods and services provided). For federal income tax purposes the taxpayer presently properly defers income under Rev. Proc. 2004-34.

FASB issued new standards, Accounting Standards Update (ASU) 2009-13 and ASU 2009-14, effective for fiscal years beginning on or after June 15, 2010, for income recognition from MDCs. Previously, if a separate deliverable was not subject to valuation under Vendor Specific Objective Evidence (VSOE), or Third Party Evidence (TPE), income from delivered and undelivered elements was combined into one unit of accounting. Income attributable to that unit was deferred and recognized as the undelivered elements were delivered. Although the actual deferral period varied depending on the products making up the MDC, for financial purposes income could be deferred until all items were delivered under a given MDC.

ASU 2009-13 provides guidance on how to separate arrangements with multiple deliverables into individual units of accounting as well as the amount allocable to each unit of accounting. ASU 2009-13 removed the requirement for objective and reliable evidence of the value of the underlying items of an arrangement, i.e. VSOE and TPE. Absent such evidence, taxpayers may use other methods to estimate income for each unit of accounting when delivered to the customer.

ASU 2009-14 applies to MDCs that include: 1) products with embedded software, and 2) non-embedded software that is more than incidental to a product sold in the same arrangement. ASU 2009-14 clarifies how revenue should be allocated and measured for these items.

For its fiscal year beginning January 1, 2011, the taxpayer adopts ASU 2009-13 and ASU 2009-14 for financial statement purposes. The taxpayer wants to use this new financial statement method in determining the extent to which advance payments are included in gross income under Rev. Proc. 2004-34. All items of income which are deferred under the taxpayer’s present method of accounting under Rev. Proc. 2004-34 will continue to be deferred pursuant to that procedure under the taxpayer’s proposed method.

LAW AND ANALYSIS

1. Change in Financial Reporting

You ask whether a taxpayer that previously elected to defer advance payments under Rev. Proc. 2004-34 is required to obtain consent under § 446(e) if the taxpayer adopts ASU 2009-13 or ASU 2009-14 and wants to use this new financial statement method in determining the extent to which advance payments are included in gross income under Rev. Proc. 2004-34. Section 446(e) generally requires that a taxpayer who changes the method of accounting on the basis of which it regularly keeps its books must, before computing taxable income under the new method, secure the consent of the Commissioner. Section 1.446-1(e)(2)(i) of the Income Tax Regulations similarly provides that a taxpayer that changes its book method of accounting must secure the

Commissioner's consent before applying its new book method of accounting for tax purposes. Specifically, the regulation states that:

> Except as otherwise provided in Chapter 1 of the Code and the regulations thereunder, a taxpayer who changes the method of accounting employed in keeping his books shall, before computing his income upon such new method for purposes of taxation, secure the consent of the Commissioner. Consent must be secured whether or not such method is proper or permitted under the Internal Revenue Code or the regulations thereunder.

Section 1.446-1(e)(2)(i). In short, a taxpayer must secure the Commissioner's consent before applying its new book method of accounting for tax purposes. Section 15.11 of the Appendix of Rev. Proc. 2011-14 clarifies that a taxpayer that previously elected to defer advance payments under Rev. Proc. 2004-34 is required to obtain consent under § 446(e) if the taxpayer subsequently changes its book method for the deferred advance payments and wants to use its new book method in determining the extent to which advance payments are included in gross income under Rev. Proc. 2004-34. Accordingly, a taxpayer that previously elected to defer advance payments under Rev. Proc. 2004-34 is required to obtain consent under § 446(e) if the taxpayer adopts ASU 2009-13 or ASU 2009-14 and wants to use this new financial statement method in determining the extent to which advance payments are included in gross income under Rev. Proc. 2004-34.

2. <u>Applicability of Rev. Proc. 2011-14</u>

In the instant situation, the taxpayer obtains consent to use its new book method in determining the extent to which advance payments are included in gross income under Rev. Proc. 2004-34 by following the automatic consent procedures of Rev. Proc. 2011-14 unless otherwise prohibited from doing so by, for example, the scope limitations of section 4.02 of Rev. Proc. 2011-14.