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## IRS Issues Final Section 451 Regulations

The IRS has issued final regulations ([TD 9941](#)) under Section 451 regarding the timing of income inclusion under an accrual method of accounting, including the treatment of advance payments for goods, services, and certain other items. (Section references are to the Internal Revenue Code of 1986, as amended.) The regulations reflect amendments made to Section 451 by the 2017 Tax Cuts and Jobs Act (TCJA) and affect taxpayers that use an accrual method of accounting (accrual method taxpayer) and have an applicable financial statement (AFS). Section 451(b) was amended to provide that, for an accrual method taxpayer, the all-events test for an item of gross income, or portion thereof, is met no later than when the item, or portion thereof, is included in revenue for financial accounting purposes on an AFS. Section 451(c) was amended to provide that an accrual method taxpayer may use the deferral method of accounting provided in section 451(c) for advance payments.

The final regulations generally adopt the proposed regulations, two sets issued in 2019, with some revisions. (See our prior coverage [here](#).) In response to comments they received, among other changes, the IRS and Treasury revised the proposed regulations as follows:

- 1. AFS Income Inclusion Rule.** The general AFS Income Inclusion Rule in the proposed Section 451(b) regulations provides that, if a taxpayer includes an item of gross income, or portion thereof, in revenue in the taxpayer's AFS, the taxpayer must include the item in gross income under Section 451(b). Under the AFS Income Inclusion Rule in the final regulations, the all-events test is met no later than when that item, or portion thereof, is "taken into account as AFS revenue." The final regulations provide two methods for determining when an item of gross income is "taken into account as AFS revenue." Additionally, under the final regulations, two additional adjustments to AFS revenue are made in determining whether an item of gross income is treated as "taken into account as AFS revenue" and apply to both methods of determination mentioned above: (a) any AFS revenue attributable to a transaction price increase is disregarded if the transaction price was increased because a significant financing component is deemed to exist under the standards the taxpayer uses to prepare its AFS, and (b) AFS revenue is increased to the extent that it reflects a reduction for (i) amounts that are the cost of goods sold or liabilities that are required to be accounted for under other provisions of the Code or (ii) amounts anticipated to be in dispute or anticipated to be uncollectable.
- 2. Cost offset for AFS income inclusions.** The proposed regulations do not provide for a cost offset when an amount is included under the AFS Income Inclusion Rule. The final regulations were revised to include the "AFS cost offset method." Generally, a taxpayer that uses the AFS cost offset method determines the amount of gross income includible for a year prior to the year in which ownership of inventory transfers to the customer by reducing the amount of revenue it would otherwise be required to include under the AFS Income Inclusion Rule for the taxable year (AFS inventory inclusion amount) by the cost of goods related to the item of inventory for the taxable year, the "cost of goods in progress offset." The net result is the amount that is required to be included in gross income for that year under the AFS Income Inclusion Rule. The deferred revenue is generally taken into

account in the taxable year in which ownership of the item of inventory is transferred to the customer.

- 3. Definitions.** The final regulations revised the definition for “transaction price.” Under the AFS Income Inclusion Rule, revenue means all transaction price amounts includible in gross income under Section 61 of the Code. The proposed regulations provided that the transaction price is the gross amount of consideration to which a taxpayer expects to be entitled for AFS purposes in exchange for transferring goods, services, or other property, but not including, among other things, “increases in consideration” to which a taxpayer’s entitlement is contingent on the occurrence or nonoccurrence of a future event for the period in which the amount is contingent. The final regulations remove the term “increases in consideration.” The concept is now subsumed by the general rule that, to determine when an item of gross income is “taken into account as AFS revenue” under the AFS Income Inclusion Rule, AFS revenue is reduced by amounts that the taxpayer does not have an enforceable right to recover if the customer were to terminate the contract at the end of the taxable year. If an amount is contingent due to a condition precedent, such as with some bonus payments, and the taxpayer would not have an enforceable right to recover such amount if the customer were to terminate the contract at the end of the taxable year, the AFS Income Inclusion Rule does not require the taxpayer to include such amount in gross income in the current year.
- 4. Special Method of Accounting.** The non-exhaustive list of examples of special methods of accounting to which the AFS Income Inclusion Rule generally does not apply was expanded to include (a) the methods of accounting for notional principal contracts under Treas. Reg. Section 1.446-3 and (b) the timing rules for stripped bonds under Section 1286.

### IRS Issues Guidance Extending Certain Payroll Tax Deferral Deadlines

The IRS, in [Notice 2021-11](#), has updated the guidance in [Notice 2020-65](#) on the deferral of withholding and depositing certain payroll taxes. (See our prior coverage [here](#).) Notice 2020-65 generally states that social security tax or railroad retirement tax withheld by employers from employee wages paid during the period from Sept. 1, 2020, through Dec. 31, 2020, is not due until the following period, Jan. 1, 2021, through April 30, 2021. Section 274 of the COVID-related Tax Relief Act required the extension of the benefits provided in Notice 2020-65. (See our prior coverage [here](#).) As such, Notice 2021-11 provides that the due date for the withholding and payment of certain taxes for applicable taxpayers is postponed until the period beginning on Jan. 1, 2021, and ending on Dec. 31, 2021. Such deferred taxes



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must be withheld and paid ratably from wages and compensation paid between Jan. 1, 2021, and Dec. 31, 2021. Because Dec. 31, 2021, is a legal holiday, payments made on Jan. 3, 2022, the next day that is not a Saturday, Sunday, or legal holiday, will be considered timely. However, if payment is not timely made, penalties and interest on the deferred unpaid tax liability will begin to accrue on Jan. 1, 2022.

### IRS Waives Requirement to File Certain Information Returns

In [Notice 2021-06](#), the IRS waives the requirement to file certain information returns or furnish certain payee statements (i.e., Form 1099 series) with respect to amounts excluded from gross income pursuant to various COVID-19 relief provisions including, PPP loans, student emergency financial aid grants, and various other programs.

### IRS Extends Deadline to Invest in QOFs Due to COVID-19

In [Notice 2021-10](#), the IRS extends the relief provided in [Notice 2020-39](#) for qualified opportunity funds (QOFs) and their investors in response to the COVID-19 pandemic. (See our prior coverage [here](#).) Notice 2021-10 provides:

1. If the last day of the 180-day investment period within which a taxpayer must make an investment in a QOF in order to satisfy the 180-day investment requirement falls on or after April 1, 2020, and before March 31, 2021, the last day of that 180-day investment period is postponed to March 31, 2021.
2. For purposes of the substantial improvement requirement with respect to property held by a QOF or qualified opportunity zone business, the period is tolled during the period beginning on April 1, 2020, and ending on March 31, 2021.
3. In the case of a QOF whose (i) last day of the first 6-month period of a taxable year or (ii) last day of a taxable year falls within the period beginning on April

- 1, 2020, and ending on June 30, 2021, any failure by that QOF to satisfy the 90-percent investment standard for that taxable year of the QOF is due to reasonable cause under section 1400Z-2(f)(3). Thus, any failure by that QOF to satisfy the 90-percent investment standard for that taxable year is not taken into account for purposes of determining whether the QOF or any otherwise qualifying investments in that QOF satisfy the requirements of section 1400Z-2 and the section 1400Z-2 regulations for any taxable year of the QOF.
4. All qualified opportunity zone businesses holding working capital assets intended to be covered by the working capital safe harbor before June 30, 2021, receive not more than an additional 24 months, including any relief provided under Notice 2020-39, for a maximum safe harbor period of not more than 55 months total (not more than 86 months total for start-up businesses), to expend the working capital assets of the qualified opportunity zone business, as long as the qualified opportunity zone business otherwise meets the requirements to qualify for the working capital safe harbor.
  5. If any QOF's 12-month reinvestment period includes June 30, 2020, that QOF receives not more than an additional 12 months, including any relief provided under Notice 2020-39, for a maximum reinvestment period of not more than 24 months total, to reinvest in qualified opportunity zone property some or all of the proceeds received by the QOF from the return of capital or the sale or disposition of some or all of the QOF's qualified opportunity zone property, provided that the QOF satisfies the requirements of Treas. Reg. Section 1.1400Z2(f)-1(b)(1) and invests the proceeds in the manner originally intended before June 30, 2020.

#### **IRS Provides Certain Partnership Penalty Relief**

In [Notice 2021-13](#), the IRS provides partnerships with relief from (a) certain penalties due to the inclusion of incorrect information in reporting their partners' beginning capital account balances on the 2020 Schedules K-1 (Form 1065) and the 2020 Schedules K-1 and (b) accuracy-related penalties for any taxable year for the portion of an imputed underpayment attributable to the inclusion of incorrect information in a partner's beginning capital account balance reported by a partnership for the 2020 taxable year.