TAX CLIENT SUCCESS STORY

armanino

COMPANY RECEIVES ADVANCE PAYMENT & TURNS TO ARMANINO TO SAVE $7M

Challenge

Company was facing a $7M tax liability due to their existing provider recommending a standard approach to accounting for an advance payment for services.

Solution

Armanino's Section 382 specialists suggested a change in accounting method – outside the norm. This allowed the company to account for the deferred revenue differently and reduced their tax liability to $0.

Result

By working with our tax advisor who was well-versed in Section 382, the company was able to save millions of dollars and reinvest those savings back into their company to meet future capital demand.

CLIENT CHALLENGE

An e-commerce company received a $30M pre-payment (deferred revenue) during year 1. However, the actual work needed to earn the deferred revenue was set to occur over the next five years. Overall, the profit on the deal was expected to be $1M (very low margins).

The company was following IRS Revenue Procedure 2004-34. What does that mean? Simply put, it's a deferral method of accounting for the treatment of advance payments, allowing a one-year deferral for eligible advance payments for services with the remaining deferred revenue to be recognized no later than the following tax year.

THE TAX ISSUE

In year 2, a new funding round triggered an ownership change under Section 382. In that same year, and following IRS Revenue Procedure 2004-34, the remaining deferred revenue had to be recognized. This generated $25M in taxable income. Unfortunately, their Section 382 limit only allowed for $5M of tax attribute utilization. This left the company with $20M in taxable income and a possible $7M tax liability (due to the 35% corporate tax rate at the time).

Company's Deferral Method Calculation

$25,000,000	Deferred Revenue (Year 2)
($5,000,000)	Section 382 Limit Reduction
$20,000,000	Taxable Income
35%	Corporate Tax Rate at Time
$7,000,000	**Tax Liability**

OUR SOLUTION

Armanino's experts came in and suggested a change in accounting method – outside the norm. Most companies want to defer income for tax purposes. But in this case, it was hurting the company and could have cost them a hefty $7M in tax. To eliminate this tax liability, we recommended a change in accounting method from the "deferral method" to the "full inclusion" method for deferred revenue. This allowed the company to treat the deferred revenue as recognized built-in gain (RBIG) prior to the ownership change. Since it was treated as RBIG, this allowed the Section 382 limit to be increased for the RBIG and reduced their tax liability to $0.

THE RESULT

By working with our tax advisor who was well-versed in Section 382, the company was able to save millions of dollars. Today – when companies are facing shelter-in-place orders, dropping revenue and an uncertain economy – access to an additional $7M in liquid assets could be the difference between your business operating versus closing. More than ever, you need advisors who understand your industry and can work with you and your unique tax situation to support your growth goals.

OUR EXPERTS

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