

# Tangible Property Regulations



*Presented by*

**Eric Wallace, CPA**

[ewallace@cpabr.com](mailto:ewallace@cpabr.com)

**(412) 977 6644**

# Tangible Property Regulations (TPRs)

- ▶ Applicable to taxpayer? Yes – if taxpayer
  - owns fixed assets, have depreciation, buy fixed assets, improves or disposes of fixed assets, and/or have material and supplies
- When Applicable? By tax year 2014
- ▶ We will cover:
  - Repairs verses capitalization (restoration, adaption, betterment, or improvement (the RABI test))
  - Unit of Property ( U of P)
  - Non-incident material and supplies (M & S)
  - De minimis safe harbor (DMSH)
  - Required and Optional Method Changes

# Table of Contents

- ▶ **Repairs of 1.162-4**
- ▶ **Unit of property**
- ▶ **RABI rules of 1.263(a)-3**
- ▶ **Routine Maintenance Safe Harbor (RMSH)**
- ▶ **Election to capitalize R & M**
- ▶ **Annual Elections**
- ▶ **Safe Harbor for Small Taxpayers (SHST)**
- ▶ **Material and Supplies of 1.162-3**
- ▶ **Election to capitalize M & S**
- ▶ **De minimis safe harbor (DMSH)**
- ▶ **Disposition of a Portion of an Asset, aka the PAD Election**
- ▶ **Identification and Basis of Asset Disposed**
- ▶ **Amounts Paid to Acquire or Produce Tangible Property**
- ▶ **Tax deductions typically available under the TPRs**
- ▶ **Detailed Work Involved for TPRs**
- ▶ **Required Tax forms that need to be filed**
- ▶ **Critical Steps Business or Clients must take to address TPRs**
- ▶ **Amounts Paid to Acquire or Produce Tangible Property**
- ▶ **TPR Method Changes**

# Acronyms

TPR,  
TR

DMSH

TP

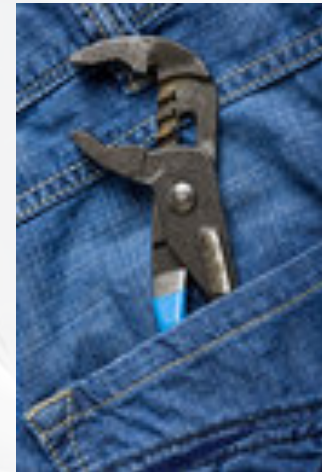
U of P

M & S





# Repairs



## What is R & M?

- Opposite of what has to be capitalized

## What has to be Capitalized?

- Improvements
- Betterments
- Adapt to new or different use
- Restorations

**SUBJECT \$\$ TO THE R.A.B.I TEST**

# Unit of Property



**Note: This is a very important  
item in the TPRs**

---

Important criteria to determine if expenditure can be written off



Unit of Property  
(U of P)

Almost always considered early in TPR issues

Smaller the U of P likely required to be capitalized

# Determining the U of P §1.263 (a)-3(e)

---

- The unit of property determination is generally based upon the functional interdependence standard:
- Functionally interdependent if the placing in service of one component by the taxpayer is dependent on the placing in service of the other component by the taxpayer
- But there are....



# Determining the UoP §1.263 (a)-3(e)

---

- Special rules are provided for
  - Buildings - each building is a U of P
  - Plant property
  - Network assets
  - Leased property
    - Leased buildings and leased property other than buildings
  - Improvements to property

# Buildings –§1.263(a)-3(e)(2)

---

- Building: each building and its structural components (as defined in §1.48-1(e)(2)) is a single unit of property
- An amount is paid to improve a building if the amount is paid for an improvement under (R.A.B.) to any of the following:
- *Building structure.* A building structure consists of the building and its structural components, or.....

# Buildings –§1.263(a)-3(e)(2)

---

## 🌐 *Building Systems:*

- HVAC, Plumbing, Electrical
- Escalators, Elevators
- Fire protection and alarm, Security
- Gas distribution
- Other as IRS provides in the future



- 🌐 Or within the building systems or building structure, any item that performs a major and discrete function
- 🌐 Or... Any large physical portion of the building,

# Amounts Paid to Improve Tangible Property—Reg. §1.263(a)-3(e)

---

- Determining the UoP—
  - Additional rules are provided if a TP has assigned different MACRS classes or depreciation methods to components of property or subsequently changes the class or depreciation method of a component or other item of property

# Other U of P Rules

---

- Improvements to property: An improvement to a U of P is generally not a unit of property separate from the unit of property improved
- Different MACRS Classes: U of P must be treated as a separate U of P if, at the time the U of P is initially placed in service by the taxpayer, the taxpayer has properly treated the component as being within a different class of property



# Amounts Paid to Improve Tangible Property—Reg. §1.263(a)-3(e)

---

- Changes to MACRS classes: In any taxable year after the unit of property is initially placed in service by the TP, if the TP or the IRS changes the treatment of that property (or any portion thereof) to a proper MACRS class or a proper depreciation method (for example, as a result of a cost segregation study or a change in the use of the property), then the TP must change the U of P determination for that property

# Unit of Property for Leased Property

---

- Lease of a building: the same as if you owned it, i.e. each building and its structural components.
- Lease portion of a building (such as an office, floor, or certain square footage): the U of P (“leased building property”) is the portion of each building subject to the lease and the structural components associated with the leased portion.

# Unit of Property Issues

---

- One tangible personal property: no problem, all separate tangible personal property is a separate U of P: Example: TP buys 100 computers. Each computer is a separate U of P
- Apartment complex consisting of several buildings: each separate building must be separate U of P
- Large mall with buildings all connected together: must use facts and circumstances to determine if the U of P is one or separate buildings

# Amounts Paid to Improve Tangible Property

i.e. the “improvement standards”,  
the R.A.B.I. rules

# Amounts Paid to Improve Tangible Property—Reg. §1.263(a)-3(d)

---

- Requirement to capitalize amounts paid for improvements
  - A TP generally must capitalize the related amounts paid to improve a unit of property owned by the TP
  - For this purpose, a unit of property is improved if the amounts paid for activities performed after the property is placed in service by the TP
  - Are for a betterment to the unit of property
  - Restore the unit of property or
  - Adapt the unit of property to a new or different use
  - i.e. the new R.A.B.I. tests/criteria/rules



# Amounts Paid to Improve Tangible Property—Reg. §1.263(a)-3(d)

---

- Improvement Criteria is not the elements that you have been used to employing. For example, the following are not in the new R.A.B.I. criteria or do not arise to the level of being a R.A.B.I.:
  - TP spends a lot of money
  - Expenditure extended the life of the asset
  - New roof shingles or roof membrane
  - Added a new air conditioner unit to the five current ones
  - Increases the capacity 5%



# R.A.B.I. rules/criteria elements/principals



## Restorations 1.263(a)-3(k)

It returns the U of P to its ordinarily efficient operating condition after it had deteriorated to a state of disrepair and no longer used

It is rebuilding to like-new condition after the end of its ADS class life

Replaces a major component or substantial structural part of the U of P (or where TP has taken a loss)

# Examples of Capitalization of Restorations

---

- 🌐 The IRS must have thought that this was an important section as it has 31 examples

Replacement of loss and sold components,

Restoration after casualty loss and casualty event

Restoration in a state of disrepair

Rebuild to a like-new condition before and after the end of class life

Not a rebuild to a like-new condition

Replacement of major component or substantial structural part

Repair performed during restoration

Numerous examples of not and replacement of major component or substantial structural part

Replacement of major component or substantial structural part; windows and floors

**Repair a broken tail light**

**Wood flooring in hotel lobby**

**Replace a power switch assembly**

**Thirty out of three hundred windows**

**Rebuild freight cars before the end of their class life**

**Two out of eight HVAC units**

**Two out of twenty sinks**

**Waterproof roof membrane**

**Written-Off Examples**



Replace siding  
200 of 300 windows  
Shore up walls  
Furnace replacement  
Building wiring  
Remodel hotel over several years  
Rebuild freight cars after end of class life  
Paint tractor cab  
Building sprinkler system  
All floors in public areas of hotel  
Entire roof  
Underground tank removal and replace  
New engine and cab of a tractor  
All restroom plumbing fixtures  
Significant portion of a roof  
HVAC system

## Capitalized Examples

## Betterments 1.263(a)-3(l)

Ameliorates a pre-existing material condition; or material defect that existed prior to placing the property in service

Material addition to the Unit of Property; Material increase in capacity, productivity, efficiency, quality, etc. to Unit of Property?

Replace part of a UoP that cannot practicably be replaced with the same type of part (for example, because of technological advancements or product enhancements), the replacement of the part with an improved, but comparable, part does not, by itself, result in a betterment to the UoP

## Betterments 1.263(a)-3(l)

Analysis of whether costs incurred to refresh or remodel a building result in a betterment requires an examination of all the facts and circumstances including, but not limited to

- The purpose of the expenditure,
- The physical nature of the work performed,
- The effect of the expenditure on the UoP

In cases in which an expenditure is necessitated by normal wear and tear or damage to the unit of property that occurred during the TP's use of the unit of property, the determination of whether an expenditure is for the betterment of the unit of property is made by comparing the condition of the property immediately after the expenditure with the condition of the property immediately prior to the circumstances necessitating the expenditure

# Biggest Issue That Is Uncertain?

---

- The biggest issue to consider in the betterment rules is what does the phrase “material betterment” mean?
- If a TP adds 2% to its warehouse space, is that a “material betterment?”
- If a TP adds 10% efficiency to its HVAC system is that a “material betterment?”
- There is no direction provided by the regulations

# Amounts to Adapt Property to a New or Different Use 1.263(a)-3(l)

Paid if the adaptation is not consistent with the intended ordinary use of the unit of property at the time originally placed in service

In the case of a building, if it adapts to a new or different use, any of the properties designated in paragraphs building structure and systems, condominium, cooperative, lease building

# Special Rules for Determining Improvement Costs—Reg. §1.263(a)-3(g)

---

- Certain costs incurred during an improvement
  - General Rule: A TP must capitalize all the direct costs of an improvement and all the indirect costs (including, for example, otherwise deductible repair costs) that directly benefit or are incurred by reason of an improvement
  - Indirect costs arising from activities that do not directly benefit and are not incurred by reason of an improvement are not required to be capitalized under Section 263(a), regardless of whether the activities are performed at the same time as an improvement

# Special Rules for Determining Improvement Costs—Reg. §1.263(a)-3(g)

---



## ● Removal Costs—

- If a TP disposes of a depreciable asset, including a partial disposition under Prop. Reg. §1.168(i)-1(e)(2)(ix), and has taken into account the adjusted basis of the asset or component of the asset in realizing gain or loss, then the costs of removing the asset or component are not required to be capitalized

# Special Rules - Related Amounts §1.263(a)-3(g)(3)

---

- Amounts paid to improve a U of P include amounts paid over a period of more than one taxable year
  - But how many years?
- Whether amounts are related to the same improvement depends on the facts and circumstances of the activities being performed





# Special Rules - Compliance with Regulatory Requirements §1.263(a)-3(g)(4)

---

- A Federal, state, or local regulator's requirement that a taxpayer perform certain expenditures on a UoP to continue operating the property is not relevant in determining whether the amount paid improves the UoP



# Regulation Requirements

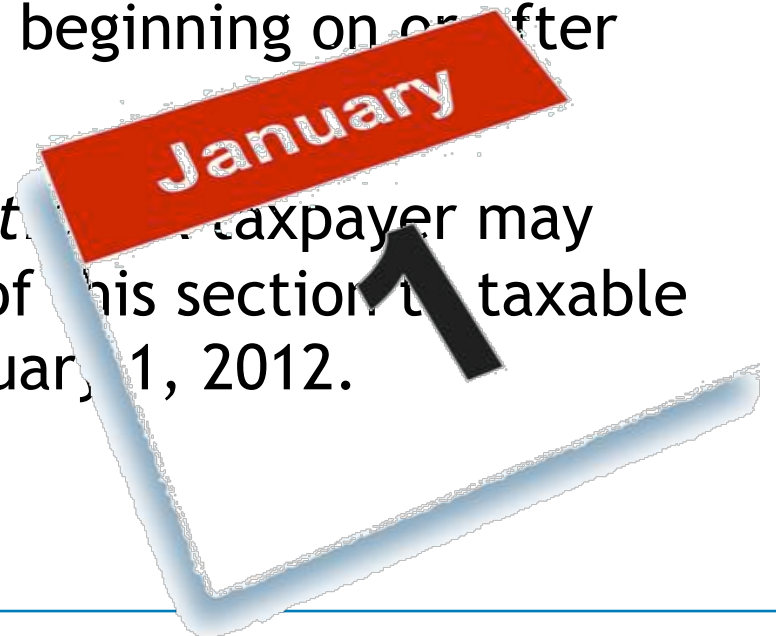
---

- **Final Regulations preamble, issued 9/2013 state:**
- The final regulations provide that.. a change to comply with the final regulations is a change in method of accounting to which the provisions of sections 446 and 481 and the accompanying regulations apply. A taxpayer seeking to change to a method of accounting permitted in the final regulations must secure the consent of the Commissioner in accordance with §1.446-1(e) and follow the administrative procedures issued under §1.446-1(e)(3)(ii) for obtaining the Commissioner's consent to change its accounting method. In general, a taxpayer seeking a change in method of accounting to comply with these regulations must take into account a full adjustment under section 481(a).

# Regulation Required Dates:



- General statement for the applicable sections state the following:
- (e) *Effective/applicability date*—(1) *In general*. This section applies to taxable years beginning on or after January 1, 2014.
- (2) *Early application of this section*. A taxpayer may choose to apply the provisions of this section to taxable years beginning on or after January 1, 2012.



# Regulation Required Dates:

---

- Then if these are effective/applicable 1-1-14 (or 2012) why do you say that certain sections in the TPRs have to be applied to transactions in prior, albeit even closed tax years?
- Eric's reading of the regs.: Because if a prior year transaction had or should have had a change, as a result of the TPR principals/rules, to an asset that is or should have been on the taxpayer's depreciation schedule, it must be changed under the rules of 446 and 481(a)....

# Regulation Required Dates

---

- **Certain TPR applicable sections instead of as of 1-1-14, state the following**

- **(j) *Effective/applicability date—(1) In general***

- This section generally applies to amounts paid or incurred in taxable years beginning on or after January 1, 2014

- **(2) *Early application of this section—(i) In general, a taxpayer may choose to apply this section to amounts paid or incurred in taxable years beginning on or after January 1, 2012***



# Regulation Required Dates

---

- 🌐 **What does this mean and what TPR items does this apply to?**
  - Means that for the applicable sections, the taxpayer will not have a 481(a) adjustment for the method change, but still must file a 3115 if the issue is applicable
  - These include
    - Material and Supplies
    - See chart of applicable dates, required and optional, and methods to implement the TPRs chart



# Regulation Requirements

---

- Beyond certain parts of the requirements requiring method changes:
  - Parts of the TPRs are elections (DMSH, PAD, SHST\*\*\*)
  - Parts of the TPRs are done for transactions after 1-1-14 (or 2012) (M & S, DMSH, SHST)
  - Parts of the TPRs are optional for prior, current or future year issues (Removal costs, PADs)
- \*\*\* de minimis safe harbor, partial asset dispositions, safe harbor for small taxpayers

# Routine Maintenance

*Buildings or for  
Tangible Personal Property*



# Routine Maintenance §1.263 (a)-3(i)

---

- RM = the recurring activities that a TP expects to perform as a result of the TP's use to keep the building structure or each building system in its ordinarily efficient operating condition
- The replacement of damaged or worn parts with comparable and commercially available replacement parts
- Routine maintenance may be performed any time during the useful life of the building structure or building systems

# Building RM

---

- However, the activities are routine only if the taxpayer reasonably expects to perform the activities more than once during the 10-year period beginning at the time the building structure or the building system upon which the routine maintenance is performed is placed in service by the taxpayer
- RM = recurring nature of the activity, industry practice, manufacturers' recommendations, and the taxpayer's experience with similar or identical property

# Routine Maintenance for Property O/T Buildings

---



The activities are routine only if, at the time the unit of property is placed in service by the taxpayer, the taxpayer reasonably expects to perform the activities more than once during the *ADS* class life of the asset

# Election to Capitalize R & M

# Importance of This Section

---

- If a TP capitalizes an expenditure that fails the R.A.B.I. test, i.e., is not required to be capitalized, and the TP capitalizes it anyway ...
- The capitalized item is subject to the “use it or lose it” rule of 1.1016
- What can a TP do to protect itself from an IRS assertion that it capitalized a R & M?
  - Do a PAD on the old asset
  - Do the 1.263(a)-3(n) election to capitalize R & M

# Election to Capitalize R&M Costs—§1.263(a)-3(n)

---

- A TP may elect to treat amounts paid during the taxable year for R&M to tangible property as amounts paid to improve that property and as an asset subject to the allowance for depreciation if the TP incurs these amounts in carrying on the TP's trade or business and if the TP treats these amounts as capital expenditures on its books and records regularly used in computing income

# Election to Capitalize R&M Costs Statement

---

- Must make election on timely filed return and attach a statement
  - Statement must be titled “ Section 1.263(a)-3(n) Election” and include the taxpayer’s name, address, taxpayer identification number, and a statement that the taxpayer is making the election to capitalize repair and maintenance costs under §1.263(a)-3(n)
- If a TP makes this election, it cannot come back in subsequent years and claim the amounts as an R&M expense under either an amended return or in a 3115



# New Annual Elections

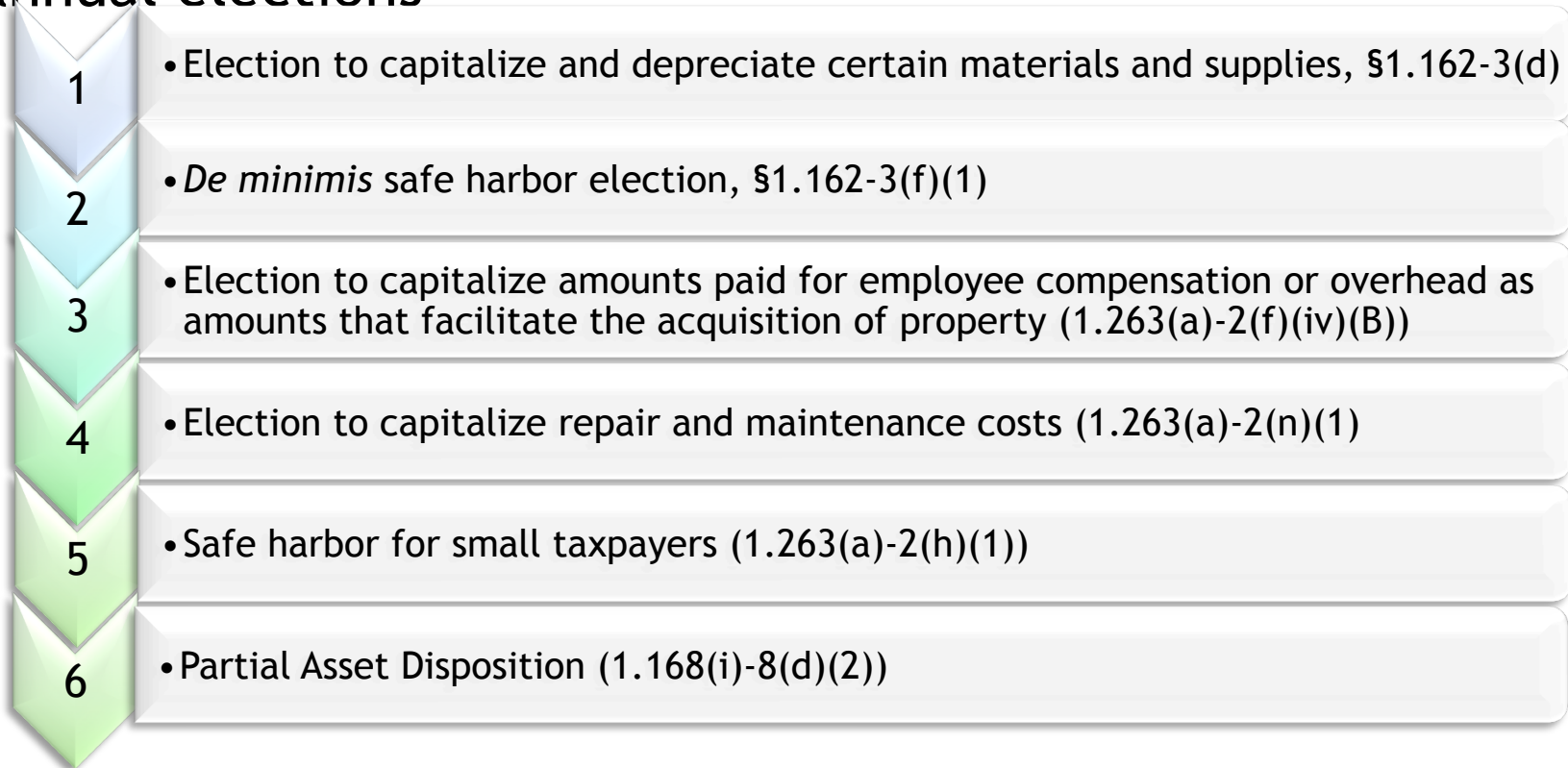
**Tangible Property Regulations**  
*An Eric P. Wallace and Boyer & Ritter CPAs Seminar*



# The Final Main TPR New Annual Elections

---

- The final and proposed regulations have six potential annual elections



# Safe Harbor for Small Taxpayers (SHST)

# Safe Harbor for Small Taxpayers

## *Reg. § 1.263(a)-3(h)*

---

- Certain TPs (must have appropriate revenues) may elect (annually) to not apply paragraph on the capitalization requirements to an eligible building property if the total amount paid during the taxable year for repairs, maintenance, improvements, and similar activities performed on the eligible building property does not exceed the lesser of
  - 2 percent of the unadjusted basis (as defined under paragraph (h)(5) of this section) of the eligible building property; or
  - \$10,000

# Safe Harbor for Small Taxpayers

## *Simplified Explanation*

---

- In order to do the SHST, the TP must



- Be a “qualifying TP,” i.e., AAGR of < \$10M



- Have “eligible” property(ies), i.e., cost or original basis of <\$1M



- Spend less than 2% of item 2 above, or \$10,000



- Include the SHST statement election on the tax return it was to employ the SHST

# Safe Harbor for Small Taxpayers

## *Reg. § 1.263(a)-3(h)*

---

- “Amount paid” does include items not capitalized under *de minimis* safe harbor or those amounts deemed not to improve under the safe harbor for routine maintenance
- Note that this does not include amounts that are not paid for the building (if the TP has separated out other asset classes from the building)
  - i.e., land or lot issues—like mowing grass

# SHST — Basis §1.263(a)-3(h)

---

## Unadjusted basis — leased property

The unadjusted basis of eligible building property leased to the taxpayer is the total amount of (undiscounted) rent paid or expected to be paid by the lessee under the lease for the entire term of the lease, including renewal periods if all the facts and circumstances in existence during the taxable year in which the lease is entered indicate a reasonable expectancy of renewal

# Safe Harbor for Small Taxpayers

## *Reg. § 1.263(a)-3(h)*

---

- Time and manner of election
  - Attach a statement to the TP's timely filed original return (including extensions) for the taxable year in which amounts are paid for R & M, improvements, and similar activities performed on the eligible building property providing that such amounts qualify under the safe harbor

# Safe Harbor for Small Taxpayers

## *Reg. § 1.263(a)-3(h)*

---

### Safe harbor exceeded

- If total amounts paid by a qualifying TP during the year for R & M, improvements, and similar activities performed on an eligible building property exceed the safe harbor, then the safe harbor election is not available for that eligible building property and the TP must apply the general improvement rules

### Other notes

- As long as the TP is under the gross receipts rule, the TP is not restricted on the number of buildings that can qualify for the SHMT rules



# Safe Harbor for Small Taxpayers

## *Reg. § 1.263(a)-3(h) – Examples*

---

- TP is a qualifying TP, owns an office building, basis of \$750k
  - TP pays \$5.5k for R & M and improvements for the building this year
  - As TP pays the lesser of \$15k (2% of basis) or \$10k, TP can elect not to apply the capitalization rules to the amounts paid
  
- Assume same as above but TP pays \$10.5k
  - Because this exceeds \$10k TP cannot apply this safe harbor rule
  - TP must apply the capitalization rules to the amounts paid

# Safe Harbor for Small Taxpayers

## *§ 1.263(a)-3(h) – Example of Lease*

---

- TP leases retail store, triple net, 20 years, \$4k/month
  - TP pays \$7k for R & M, improvements, etc.
  - The calculated basis of the leased U of P is \$960k
    - \$4k x12 x20
  - As the TP total amounts paid meet the SFST, TP may elect not to apply the capitalization rules to the amounts it paid
  - Amounts paid will be considered ordinary and necessary

# Material & Supplies (M & S)

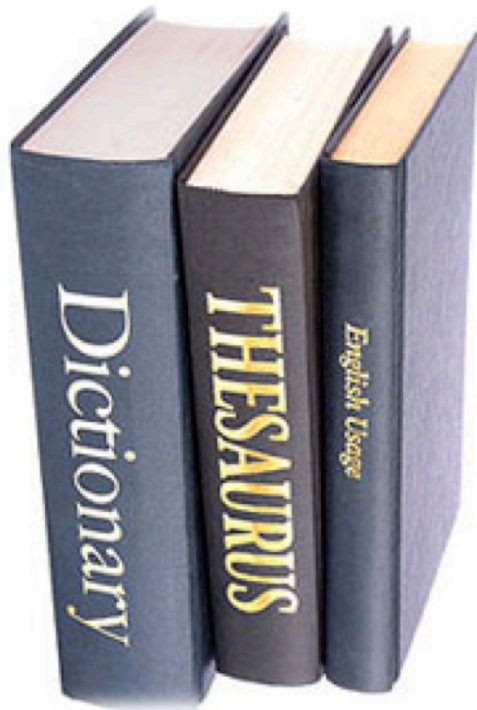
**New Rule: All taxpayers must “defer”  
all non-incident M & S Until Used or  
Consumed**

**Note: this is probably the most  
complicated set of rules to understand  
(for the smallest dollar amount of the  
TPR issues...)**

# Definition of Incidental and Non-Incidental M & S

---

## 1.162-3(a)(2) – Incidental



- Amounts paid to acquire or produce M & S that are carried on hand and for which no record of consumption is kept or of which physical inventories at the beginning and end of the year are not taken, are deductible in the taxable year in which these amounts are paid

# Definition of Incidental and Non-Incidental M & S

---

## 1.162-3(a)(1) definition – Non-incidental

- Amounts paid to acquire or produce M & S are deductible in the taxable year in which the M & S are used or consumed in the taxpayer's operations
  - Final change method #186 applies to a TP that wants to change its method of accounting for non-incidental M & S (in §1.162-3T(a)(1), (c)(1)), to comply with the definition and to change to deducting such amounts in the year in which they are actually used or consumed
  - This is required for just about all taxpayers by tax year 2014



# Definition of Material and Supplies

---

We now have the following groups of types of M & S, when the final TPRs are effective, by tax year 2014:

- 1 • Non-incidental (includes rotatable, temporary, or standby emergency spare parts)
- 2 • Fuel or Bulk
- 3 • Units of Property with life of less than one year
- 4 • Units of Property with cost of \$200 or less

# Definition of Material and Supplies

---

- If the TP elects the DMSH, then the TP must apply the DMSH to all M & S
  - Except for items capitalized and rotatable and temporary spare parts



# Definition of Incidental (1) and Non-Incidental (2) M & S

---

- Note that these definitions apply whether the TP is complying or not
  - In other words, just because a TP currently writes off all of its M & S currently, does not mean that all of its M & S are incidental starting in 2014
  - Generally, any M & S items/amounts in excess of a TP's DMSH are non-incidental
  - If TP does not do the DMSH then all non-incidental M & S must be deferred, no matter what \$\$\$ amount. Yes, even below \$200
-



# Definition of “defer”

---

- What I mean by “defer” is that the non-incidentals M & S cannot be written off until used or consumed in the TP business
- “Defer” can be done through an M-1 or M-3 on the tax return, or
- The TP can set up a balance sheet account, at least for tax purposes, to inventory these amounts until used or consumed.
- Non-incidentals M & S are not prepaids -
  - prepaids are intangibles, M & S are not

# Election to Capitalize and Depreciate Certain M & S

# Specifics of the Election to Capitalize M & S

---

- This an annual election made item by item, but only if made by the TP
- A TP may elect to treat as a capital expenditure and to treat as an asset subject to depreciation the cost of any rotatable, temporary, or standby emergency spare part (§1.162-3(d)(1))



# Specifics of the Election to Capitalize M & S

---

## Applicability

- An election made applies to amounts paid during the taxable year to acquire or produce any rotatable, temporary, or standby emergency spare part to which paragraph (a) of this section would apply
  - *But for the election under this paragraph (d)*
- Any property for which this election is made shall not be treated as a M & S
  - i.e., it will be treated as an asset

# Specifics of the Election to Capitalize M & S

---

- Cannot elect to capitalize fuel or bulk
- Cannot elect to capitalize parts if ...
  - The part is a U of P with a life of 12 months or less
  - The part is a U of P with a cost of \$200 or less
    - More if the DMSH is elected
  - The part is going to be a component of a U of P and that U of P is not being depreciated, or
  - The optional method of accounting for rotatable or temporary spare parts is being used for those parts

# Example of Applying the Rules Related to ‘Election to Capitalize M & S’

---

- TP buys a pickup truck for \$4,500 and that amount is under the TP’s DMSH
- TP separately buys tires for that pickup
  - TP cannot capitalize those tires
  - Why?
- Because the pickup is not being depreciated – the pickup was written off under the TP’s DMSH

# Manner of the Election to Capitalize M & S

---

- Is done by ... just capitalizing the amounts for the parts in the taxable year when the asset is placed in service by the TP
- This election is made *by each part* by just capitalizing the amount
- No special wording is required
- Class life has to match the class life of the asset the part is associated with, unless the part has a specifically separate defined class life per Rev. Proc. 87-56

# Example of the Manner of the Election to Capitalize M & S

---

- TP buys 100 tires that cost more than the TP's DMSH per item and stores them for use
- TP wants to capitalize and depreciate all of these tires in the year purchased
  - Q: Can it?
  - A: No
    - TP can only capitalize and depreciate the tires that are placed in service by the TP



# Example of the Manner of the Election to Capitalize M & S

---

- If TP puts 4 tires on a vehicle, then the TP can elect to depreciate those tires in that tax year
  - Q: What class life to use?
  - A: Same class life as the vehicle
    - Unless it is an over-the-road tractor

# De minimis safe harbor



# The DMSH Is a Final TPR New Annual Election

---

## DMSH (§1.162-3(f)(1))

- A TP with and without an AFS may not capitalize any amount paid in the taxable year for the acquisition or production of a unit of tangible property nor treat as a material or supply under §1.162-3(a) any amount paid in the taxable year for tangible property if the amount specified meets the rules
  - \$500 and \$5,000 per item/invoice respectively

# First Element ...

*Get a DMSH Policy in Place before the Tax Year Begins*

---



Non-AFS DMSH

AFS DMSH

- ❖ To take advantage of either of these, a TP must have an accounting policy in place before January 1, 2014, if calendar year TP who wants to do the DMSH for 2014

# First Element of the DMSH

---

- An accounting policy in place response is required for all separate trades or businesses and any separate legal entities, such as single-member LLC
- If no accounting policy in place, TP will be limited to \$200 per item/invoice (BUT only if the TP has a method #186 or #187 in place)

# DMSH Policy in Place Elements

## *Non-AFS DMSH*

---



What are all of the required elements in an accounting policy for a non-AFS TP?

# DMSH Policy in Place Elements

## *Non-AFS DMSH*

---

Have an accounting policy in place

Specify a write off dollar amount

Be in place before the beginning of the TP year

Actually write the items off for books

Apply the DMSH to all items that qualify

# DMSH Policy in Place Elements

## *AFS DMSH*

---

What are the additional required elements in an accounting policy for an AFS DMSH TP?





## Applicable Financial Statements

FS required to be filed with the SEC

Certified audited FS

- Used for credit purposes
- Reporting
- Other substantial non-tax purpose

Defined as financial statements that have the highest priority

FS required to be provided to the federal or a state government or agencies

- Other than the SEC or IRS

# DMSH Policy in Place Elements

## *Three More for AFS DMSH*

---

The accounting policy MUST  
also, before the tax year

Be documented

Be communicated

Have an applicable financial statement

**Note:** With an AFS a TP will be writing the amounts off for financial statement purposes, not for “books”

# Application of the DMSH to other TPR Issues



# *De Minimis Safe Harbor Manner of the Election*

---

- TP makes the election by attaching a statement to the TP's timely filed original tax return (including extensions) for the taxable year in which these amounts are paid
- Statement must be titled “ Section 1.263(a)-1(f) *de minimis* safe harbor election” and include the TP's name, address, TP identification number, and a statement that the TP is making the *de minimis* safe harbor election under §1.263(a)-1(f)
- The election cannot be made on a Form 3115 nor on an amended tax return

# DMSH

## *Annual Election Example*

---

- *De minimis* Safe Harbor Election Under 1.263(a)-1(f)
  - *ABC Business, Inc., EIN 12-34567890, 123 Main Street, St Louis, MO*
  - *ABC hereby elects the De minimis Safe Harbor Election Under 1.263(a)-1(f) for tax year 2014*
- **Note:** *We do not tell the IRS what our DMSH amount is or any other capitalization policy details*

# DMSH

## *Other Rules to Remember*

---

- TPs that do not elect the DMSH must treat amounts paid for M & S in accordance with Reg. §1.162-3
- TPs subject to 263A can not avoid those provisions by using the *de minimis*
- DMSH does not apply to inventory, land, items it capitalizes, and the optional method of rotatable parts
- *Big Advantage*
  - *DMSH is deducted as ordinary and necessary expense – so no recapture on sale*

# DMSH and the Interaction with the IRS

---

- DMSH does not preclude a TP from reaching an agreement with the IRS that the IRS examining agents will not review certain items
- “Examining agents do not need to revise their materiality thresholds in accordance with the safe harbor limitations”



# DMSH and Amounts Exceeding the DMSH

---

- The DMSH is a safe harbor
  - It is not a “not to exceed” limitation
- In other words, if a TP has a capitalization policy that exceeds the safe harbor amounts (\$500/\$5,000) it can still write off the amounts up to its cap policy, it will just have to support those higher amounts upon IRS audit



# Exceeding the DMSH

## *Example BCD*

---

- BCD is a Non-DMSH TP
  - BCD has a capitalization policy to write off all items \$1,000 and under before 2014
- For 2014 BCD purchases 10 items under \$500 and 10 items over \$500 but under \$1,000
- BCD elects the DMSH for 2014
  - Q: What can BCD write off for 2014?
  - A: BCD can write off all of the items under \$1,000 — it will just not have a “safe harbor” for the items over \$500

# Exceeding the DMSH

## *Example BCD*

---

- Q: As BCD is going to deduct its amounts under its capitalization policy up to \$1,000, why should BCD bother to even comply with the DMSH rules (i.e., cap policy in place, set a dollar amount, match for books, elect on return)?
- A: Because if BCD does not comply with the DMSH it will default to the no-DMSH rules, i.e., all items over \$200 have to be capitalized and all non-incidentals M & S over \$.01 have to be deferred
  - In other words, the DMSH enables BCD to have the right to have a capitalization policy ...

# Disposition of a Portion of an Asset



*How to Elect, Subsequent to  
IRS Change, Special Rules  
for 2012 or 2013 Returns*

# Partial Asset Disposition (PAD) Election

*But If PAD for Prior Year Asset  
Dispositions, We Have a  
Required Method Change*

# The Final Main TPR New Annual Elections

---

- Disposition of a portion of an asset (aka partial disposition election) (§1.168(i)-8(d)(2))
  - A taxpayer may make an election under this paragraph (d)(2) to apply this section to a disposition of a portion of an asset
  - Must make the election by the due date (including extensions) of the original federal tax return for the taxable year in which the portion of an asset is disposed of by the TP

# Disposition Rules

---

Since 1981: We *must add as a new depreciable item building systems or structural components and cannot write off the old disposed part*

New Rules: We *have the choice to write off the old*

- A. Current year “partial” asset dispositions and elections for each and every future year disposition (s)
- B. Prior year “partial” asset dispositions
  - Must file 3115 by 2013/2014 or lose that opportunity

# F MACRS Disposition TPR Rules

---

- Generally, the partial disposition rule is elective
- It is required to be applied in the following cases
  - Casualty event
  - Gain is not recognized under 1031 or 1033
  - Step in the shoes transaction
  - Sale of a portion of an asset
- Disposition of an asset, if elected, can apply to any type of MACRS property, but if included in asset classes 00.11 thru 00.4 of 87-56 must be classified under same asset class as the disposed portion

# Before you dispose of a prior capitalized building asset ...

Do the monies spent have to be capitalized?

No

Write those amounts off and do nothing else

Yes

“Can I write off any old, previously capitalized asset(s)?” Still have basis or want to deduct removal costs?

Yes

Do you want to?

Yes

Elect PAD/current do #177 & 196/prior years

No

Do not elect partial asset disp.



Building and Structural  
Components 1.263(a)-3(e)(2)  
(U of P)

Old Rule: Taxpayer was required to depreciate building improvements over the life of the original asset

New Rule: replace a roof, choose to recover as a loss the remaining basis of the old roof, book the new roof and depreciate it

# MACRS

---

Definition of  
disposition is  
broad

Manner of  
disposition —  
does not matter

# MACRS

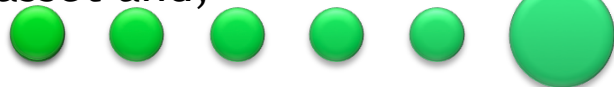
## *Disposition – Gain or Loss*

---

TP accounts for asset disposed of in a MAA or pool, or



Asset disposed of is a component of a larger asset and;

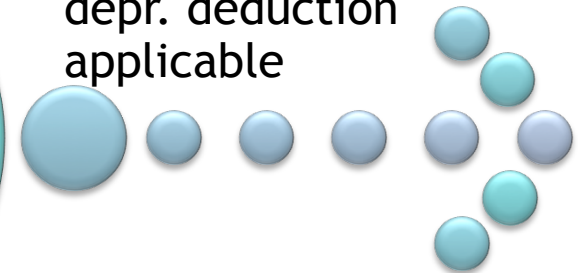


It is impracticable from the TP's records to determine unadjusted depreciable basis of the asset disposed of



May use any reasonable method that is consistently applied

Must use the method, period, conv. And 1<sup>st</sup>-yr. depr. deduction applicable



# Accounting and Disposition Rules for MACRS Property – P TPRs

---

F and P TPRs provide that each MAA must include, in most cases, assets that have the same depreciation method, recovery period, and convention, and that are placed in service in the same taxable year

# Manner of Making the Partial Asset Disposition Election

---

- TP must make the (d)(2)(i) election by the due date (including extensions) of the original federal tax return for the taxable year in which the portion of an asset is disposed of
- Election is made by applying the provisions of (d)(2)(i) for the taxable year in which the portion of an asset is disposed of by the TP, by reporting the gain, loss, or other deduction on the TP's timely filed return for that taxable year
- If subsequently the IRS reclassifies a repair as an asset, TP can elect at that time to do the PAD (#197), if the TP owned the asset as of the beginning of the tax year

# Applying the Partial Election to 2012-3

---

- TP can subsequently make the (d)(2) election by filing either
  - A. An amended tax return on or before 180 days from the due date, including extensions, even if not extended or
  - B. A 3115 filing with the TP's timely filed tax return for the first or second taxable year succeeding the applicable tax year

# Basis of Asset Disposed of under P or F TPRs

---

- Equals the adjusted depreciable tax basis
- The TP may use any reasonable method for purposes of determining the unadjusted depreciable basis of the disposed portion of the asset
- If TP disposes of more than one portion of the same asset, the TP may use any reasonable method that is consistently applied to all portions of the same asset for purposes of determining the unadjusted depreciable basis of each disposed portion of the asset

# Basis of Asset Disposed of under P or F TPRs

---

- As of the first day of the taxable year in which the disposition occurs, the disposed portion is placed into a single asset account
- Unadjusted depreciable basis of the asset must be reduced by the unadjusted depreciable basis of the disposed portion of the first day of the taxable year in which the disposition occurs
- The depreciation reserve of the asset must be reduced by the depreciation allowed or allowable for the disposed portion as of the end of the taxable year immediately preceding



# Basis of Asset Disposed of under P TPRs

---

For the adjusted depreciable basis of the disposed portion at the time of disposition (taking into account the applicable convention), the depreciation allowed or allowable for the disposed portion is computed by using the depreciation method, recovery period, and convention applicable to the asset in which the disposed portion was included and by including the portion of the additional first year depreciation deduction claimed for the asset that is attributable to the disposed portion

# MACRS

## *Determination of Basis & Identification Asset Disposed of 1.168(i)-8*

---

- When it is impracticable from the TP's records to determine the particular taxable year in which the asset was placed in service by the TP, the TP must identify the asset by using the methods allowed when the asset is in a general asset account or a multiple asset account
  - The first-in, first-out (FIFO) method, the modified FIFO method, a mortality dispersion table if the asset is a mass asset, or any other method designated by the Secretary in published guidance
  
- A last-in, first-out (LIFO) method is not permitted

# Accounting for the Asset Disposed of

---

- Depreciation ends for an asset at the time of the asset's disposition
- If the TP accounts for the asset disposed of in a MAA or pool, then
  - As of the first day of the taxable year in which the disposition occurs, the asset disposed of is removed from the multiple asset account or pool and is placed into a single asset account
  - The unadjusted depreciable basis of the multiple asset account or pool must be reduced by the unadjusted depreciable basis of the asset disposed of as of the first day of the taxable year

# PAD Election

---

- For other transactions, a disposition includes a disposition of a portion of an asset only if the taxpayer makes the partial disposition election for that disposed portion
- A taxpayer may make the partial disposition election for the disposition of a portion of any type of MACRS property, including an asset that is properly included in one of the asset classes 00.11 through 00.4 of Rev. Proc. 87-56
  - However, a taxpayer making the partial disposition election for the disposition of a portion of an asset that is properly included in one of the asset classes 00.11 through 00.4 of Rev. Proc. 87-56 must classify the replacement portion of the asset under the same asset class as the disposed portion of the asset

**ELECTION**



# How to Make the PAD Election For Prior Year PADs in a 3115 Filing

---

- This section addresses PADs from tax years prior to 2012 (i.e., 2011 back in time)
- The final MACRS provide us this “opportunity” in the new 1.168(i)-8(d)(2)
  - Except as provided in paragraph (d)(2)(iii) [i.e., Special rule for subsequent Internal Revenue Service adjustment] or (iv)(B) [an application for change in accounting method with the taxpayer’s timely filed original 2013 (for 2012) or 2014 (for 2012 or 2013) return] of this section or except as otherwise expressly provided by other guidance published in the Internal Revenue Bulletin (see §601.601(d)(2) of this chapter), the election specified in paragraph (d)(2)(i) of this section may not be made through the filing of an application for change in accounting method

# Prior Year PADs – Only by 2014

---

- The underlined words above provide us anticipation that the revenue procedure that will replace RP 2014-17 will allow taxpayers the chance to write off prior tax years duplicate assets that remain on the depreciation schedules
- It is anticipated that this “opportunity” will only for applicable to tax year 2014
  - I expect that the new RP will just modify the current automatic methods #177, #178, and #196 to enable this
  - No 4797 nor 4562 would be required to be filed in order to take prior year PADs that are part of a 3115 filing

# IRS Disallowance of a Taxpayer's Characterization

---

- When the IRS disallows a taxpayer's repair deduction for the amount paid or incurred for the replacement of a portion of an asset and capitalizes such amount under §1.263(a)-2 or §1.263(a)-3, the taxpayer may make the partial disposition election for the disposition of the portion of the asset to which the IRS's adjustment pertains by filing an application for change in accounting method, provided the asset of which the disposed portion was a part is owned by the taxpayer at the beginning of the year of change



# Identification and Basis of Asset Disposed

*How to Calculate the Adjusted Basis and the “Reasonable Method” Various Ways Including the Replacement of the CPI Rollback with the PPI Rollback*





# Determining the Appropriate Disposed Asset

---



- 🌐 In general, the facts and circumstances of each disposition are considered in determining the appropriate disposed asset



# Determination of Basis of Disposed Asset

---

- Impracticable from the taxpayer's records to determine
- The IRS and the Treasury Department expect that reasonable methods are available that use information readily available or known to the taxpayer and do not necessitate undertaking an expensive study
- These final regulations also provide nonexclusive examples of reasonable methods
  - These examples are the same examples in the 2013 proposed regulations, except that the final regulations do not include discounting the cost of the replacement asset by the Consumer Price Index as an example of a reasonable method



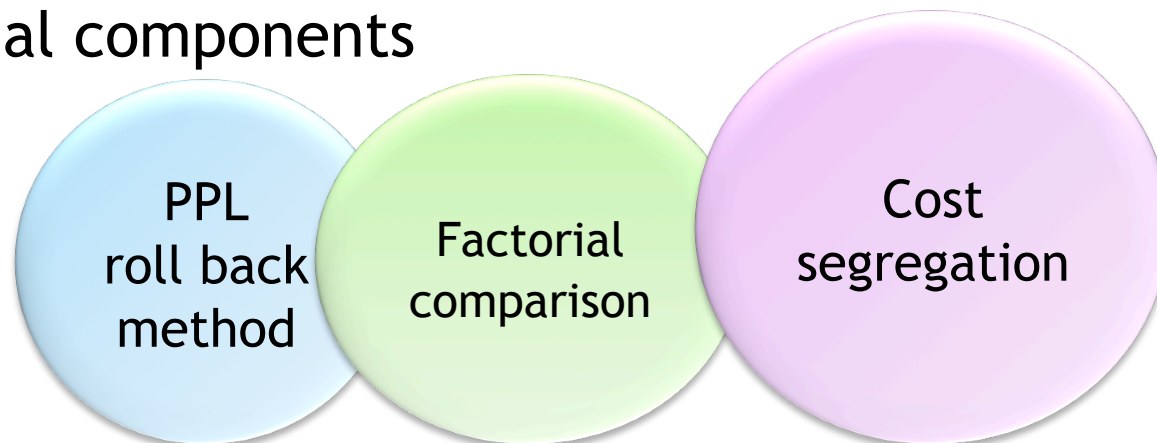
# PPI

- The IRS and the Treasury Department have determined that the Producer Price Index for Finished Goods (and its successor, the Producer Price Index for Final Demand) more accurately reflects inflation for capital expenditures
- Discounting the cost of the replacement asset using the Producer Price Index for Finished Goods is a reasonable method only if the replacement asset is a restoration under §1.263(a)-3(k) and is not a betterment under §1.263(a)-3(j) or is not an adaptation to a new or different use under §1.263(a)-3(l)

# Reasonable Methods

● The examples of reasonable methods include the following

- 1) Discounting the cost of the replacement asset to its placed-in-service year cost using the Producer Price Index for Finished Goods
- 2) A *pro rata* allocation
- 3) A study allocating the cost of the asset to its individual components



# Example #8

## *PPI Discounting*

---

- LMN purchased a building in June of 2004 and replaced 60% of its roof in March of 2014 for \$500,000 and capitalized the new roof and makes a current year PAD election
- LMN uses the PPI rollback method and calculates the basis of the roof disposed of, and the accumulated depreciation on it as follows



# Example #8

## PPI Discounting

- Determine the PPI in June of 2004 and March of 2014

Item:	Finished goods											
Base Date:	198200											
Years:	1960 to 2014											
Year	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
1990	117.6	117.4	117.2	117.2	117.7	117.8	118.2	119.3	120.4	122.3	122.9	122.0
2003	140.8	142.3	144.2	142.1	142.0	143.0	143.0	143.7	144.0	145.5	144.5	144.5
2004	145.4	145.3	146.3	147.3	148.9	<b>148.7</b>	148.5	148.5	148.7	152.0	151.7	150.6
2005	151.4	152.1	153.6	154.4	154.3	154.2	155.5	156.3	158.9	160.9	158.3	158.7
2013	194.8	196.3	196.6	195.9	196.8	197.2	197.2	197.9	197.3	196.9	196.0	196.5
2014	198.0	198.8	<b>199.9</b>	202.0	201.6	202.6						

# Example

## *PPI Discounting*

---



- Math you need to do is
  - Date new asset placed in service is March of 2014
  - Date of original asset placed in service that was replaced is June of 2004
  - PPI from March of 2014 is 199.9 and for June of 2004 was 148.7
  - Doing the PPI rollback of \$500,000 gives us the following amount
    - $(\$500,000 * 149.7 \text{ divided by } 199.9) = \$374,437$

# Example

## *PPI Discounting*

---

- Now have to subtract the accumulated depreciation from the recalculated basis gives us the amount to write off in 2014, if the TP makes the PAD in 2014
- $\$374,437 - \$93,617 = \$(280,820)$
- Recall that as a current year PAD, this is not a 481(a) adjustment, but rather LMN reports this amount in its 4797 for the 2014 tax year.



# Example

## *Pro Rata Allocation*

---

- LMN instead determines that it cannot use the PPI rollback method and instead wants to employ a *pro rata* allocation
  - Recall that LMN purchased the building in June of 2004 and replaced 60% of its roof in March of 2014 for \$500,000 and capitalized the new roof and makes a current year PAD election
  - Additional facts
    - LMN purchased the building for \$5.0M in 2004 from a real estate developer who built the building for \$4.0M two years before
    - The developer provided cost information to LMN that of their \$4.0M total cost, the roof cost was 9%

# Example

## *Pro Rata Allocation*

---

- LMN then multiplies its \$5.0M cost by 9% and *pro rata* calculates its original roof cost to be \$450,000
  - LMN then calculates depreciation on this amount to the disposal date ( $\$450,000 \times 25.02\%$ ) and obtains depreciation to date of \$112,509 resulting in a write off of \$(337,491) ( $\$450,000 - 112,509$ ) in its 2014 IRS form 4797

# Example

## *Cost Segregation*

---

- Same facts as above for LMN but LMN also obtains a cost segregation on the building in 2004
  - In that cost segregation, the roof was shown to have a value of \$350,000 at the time of purchase
  - Using this amount, LMN calculates the depreciation to be \$87,570 ( $\$350,000 \times 25.02\%$ ), which results in a loss of \$(262,430) ( $\$350,000 - 87,570$ ) in its 2014 IRS Form 4797

# Tax Deductions Typically Available from the Implementation of the TPRs

# Tax Deductions for Prior Tax Years

---

- Repairs and Maintenance that were previously capitalized that when now viewed under the tenets/principals of the final regulations never should have been capitalized

# Tax Deductions for Prior Tax Years

---

- These items relate to the following method changes
  1. #184 - R & M items that are on the taxpayer depreciation schedule, that when now viewed under the principals of the final TPRs never needed to be capitalized
    - These are usually very big deductions
    - The deduction (i.e., the negative 481(a)) is equal to the remaining tax depreciable basis on the 12-31-13 tax depreciation schedule
    - This deduction and related method change, is required, not optional, and must be done by tax year 2014 or scope limitation opportunity is gone
    - If the taxpayer does not make this method change by 2014, the net remaining tax basis is subject to the “use it or lose it rules” of new reg. 1.1016-3

# Tax Deductions for Prior Tax Years

---

- Depreciation “Impermissible” Methods
- Examples:
  - We incorrectly depreciated a 5 year asset as a 15 year asset
  - We classified a 15 year as a 39 year asset
  - The difference is a tax current year write off

# Tax Deductions for Prior Tax Years

---

2. #7 - Depreciation impermissible to permissible method changes (i.e., generally class life or bonus incorrect or assets not depreciated that should have been)
  - Use it or lose it rule also applies
  - Also typically big deductions
  - If these issues exist, this method change is also required,
  - Does not have the scope limitations, i.e., a taxpayer can file this method change in any tax year
  - Be warned, however—if the taxpayer does not file this method change before notification of an IRS audit—it will be too late to file



# Tax Deductions for Prior Tax Years

---

- We bought a building in the year 2000 and in 2005 put on a new roof, 2008 new windows, and in 2010 replace the parking lot
- The “duplicate” roof, windows, and parking lot “net remaining tax depreciation” can be written off in the current tax year with the filing of IRS Form 3115

# Tax Deductions for Prior Tax Years

---

3. #177 and/or 178: For prior year partial asset dispositions (for building or assets other than buildings, respectively)
  - We now know these can be done for tax year 2014 as well as 2012 and 2013 with the release of the final MACRS Disposition TPRs
  - The dollar amount of the deduction can be quite significant
  - If the taxpayer has a current year PAD, just do the annual election, no 3115 required
  - The amount of the deduction can be done using “any reasonable method consistently applied”

# Tax Deductions for Prior Tax Years

---

4. Other potential deductions include, but usually are not as significant as the first three
- Routine Maintenance (under method #184)
  - Removal costs (under method #21)
  - Salvage value that can be written off (not a TPR issue but may be noticed when “scrubbing” the depreciation schedule for TPR items)
    - There are special rules for salvage value of assets, i.e., pre-ACRA and pre-MACRS assets that are not in the TPRs

# Tax Deductions for **Current** and **Future** Tax Years

---

- These items relate to either the employment of the TPR principals or the annual elections of the following
  - Testing expenditures under the R.A.B.I. rules
    - We find that many expenditures that we thought required capitalization now do not under the TPRs
  - *De minimis* safe harbor
    - No dollar ceiling limitation
  - Landlord tenant improvement costs

# The Detailed Work That Is Involved to Determine Those Deductions

# Proof and Fixed Assets Decisions

---

- The IRS does not have to disprove what the taxpayer files
- It is the taxpayer that must be able to prove—i.e., support any 481(a)s calculated
- Support can come from prior invoices, plans, documents to even testimony from individuals
- When scrubbing the depreciation schedules, the taxpayer should retain documentation or support for its conclusion related to 481(a)s for its 3115 filings, but also for every expenditure it makes in the current and future years—i.e., why such is or is not a R.A.B.I.

# Which 481(a)s Take the Most Effort?

---

- If the taxpayer already had its 481(a)s calculated related to the required TPRs and had those in a schedule ready to file with the 3115, employing the TPRs would be a much easier process
- ***The true TPR effort is in (A) identifying the issues and (B) calculating the 481(a)s***
- The amount of the total 481(a)s (for a particular method change) will often depend on the facts and circumstances of transactions that occurred years ago
- Obtaining the data or facts and circumstances in order to make informed decisions is what takes time

# Difficulty of the Various 481(a)s

---

## For R & M items?

- Focused on the decision as to why it is not a R.A.B.I.
- Calculating the R & M 481(a) is easy—it is the net remaining tax depreciable basis as of the beginning of the tax year in which the 3115 is filed (i.e., 1-1-14)

## For Depreciation Impermissible Methods?

- Just have to do simple math to compare what depreciation was taken to what should have been taken
- No real support or proof needed, just know what activity the taxpayer is in and that the asset is employed in that activity (see RP 87-56)



# Difficulty of the Various 481(a)s

---

## 🌐 For Routine Maintenance 481(a)?

- Proof related to why you expect to incur more than once during 10 years (for building) or ADS class life (for personal property)
- 481(a) is an easy calculation after that

## 🌐 For Removal Costs?

- Remember that this is not required
- If you want to do this, you are going to have to obtain evidence
- Evidence for removal costs for prior years is difficult

# The Required Tax Forms That Need to be Filed

# The TPR Method Changes Are 99.9% Automatic

---

- If the method change has a number assigned to it by the IRS, it is an automatic method change
- All TPR methods have automatic method numbers (##21, 184 to 194, 175 to 180, 195 to 200)
- Automatic method changes do not require a filing fee to file
- Can be done by the due date of the tax return, including extensions
- Be careful, once the scope limitations are done (i.e., expire for tax years after 2014) only advance consent method change may be available

# Scope Limitations of RP 2011-14 and the Changes Made in RP 2014-16 and 2014-17

---

1. RP 2011-14, in its Section 4.02 limits the ability of TPs to file 3115s related to the same type of tax accounting method filings within a certain time limitation, and other limitations
2. These limitations or restrictions are waived for filing method changes #175 to #180 and #184 to #193, but only for any tax year beginning before Jan. 1, 2015

**What about the F MACRS Disposition method procedures?  
We do not know yet ...**

# Scope Limitations of RP 2011-14 and the Changes Made in RP 2014-16 and 2014-17

---

3. Method #21 for removal costs is exempt from the scope limitations without a time limitation

## 4. Conclusions

- a) All TPs must file their F TPR method changes no later than their 2014 income tax year filings except for method #21
- b) Must file P TPRs by 2013—**may** have to refile or revise those in 2014
- c) F MACRS Disposition TPRs are now good for 2014
  - a) Do not know yet if we can file after 2014 ...

# Scope Limitations of RP 2011-14 and the Changes Made in RP 2014-16 and 2014-17

---

5. If the TP does not file any TPR method filings, the signer has Circular 230 considerations
  - a. The IRS has also advised that it will look for TP who have not filed any 3115s
  - b. If the TP does file a 3115 but leaves off any TPR methods/issues or citations on a filed 3115, unless the IRS supplies an “out,” it will be prohibited from filing the same 3115 method for five years

# Scope Limitations

## *Examples*

---

### 1. TP does not file any 3115s through 2014

- **Warning:** the IRS has promised that it will look at TPs who did not file any TPR 3115s
- In 2015 the TP switches CPA firms, the new CPA firm helps the TP to file TPR 3115s, can it?

**A:** Sure, as long as it files before it is notified of an IRS audit, it will be permitted as the TP did not file any 3115s that would restrict it from the scope limitation

# Scope Limitations

## *Examples*

---

2. TP does file a #184 3115 through 2014, but misses the 481(a) negative adjustment for R & M items on that filing
- Yikes, that TP has some big issues, as it now cannot file another 3115 due to the scope limitation
    - Recall that exception expired at the end of 2014





# Scope Limitations

## *Examples*

---

3. TP does not file a #21 for removal costs through 2014

- In 2015 it has a current year partial asset disposition and wants to deduct removal costs

**A:** The TP can file a #21 for 2015 as the scope limitation of RP 2011-14 does not apply to method #21



# Scope Limitations

## *Examples*

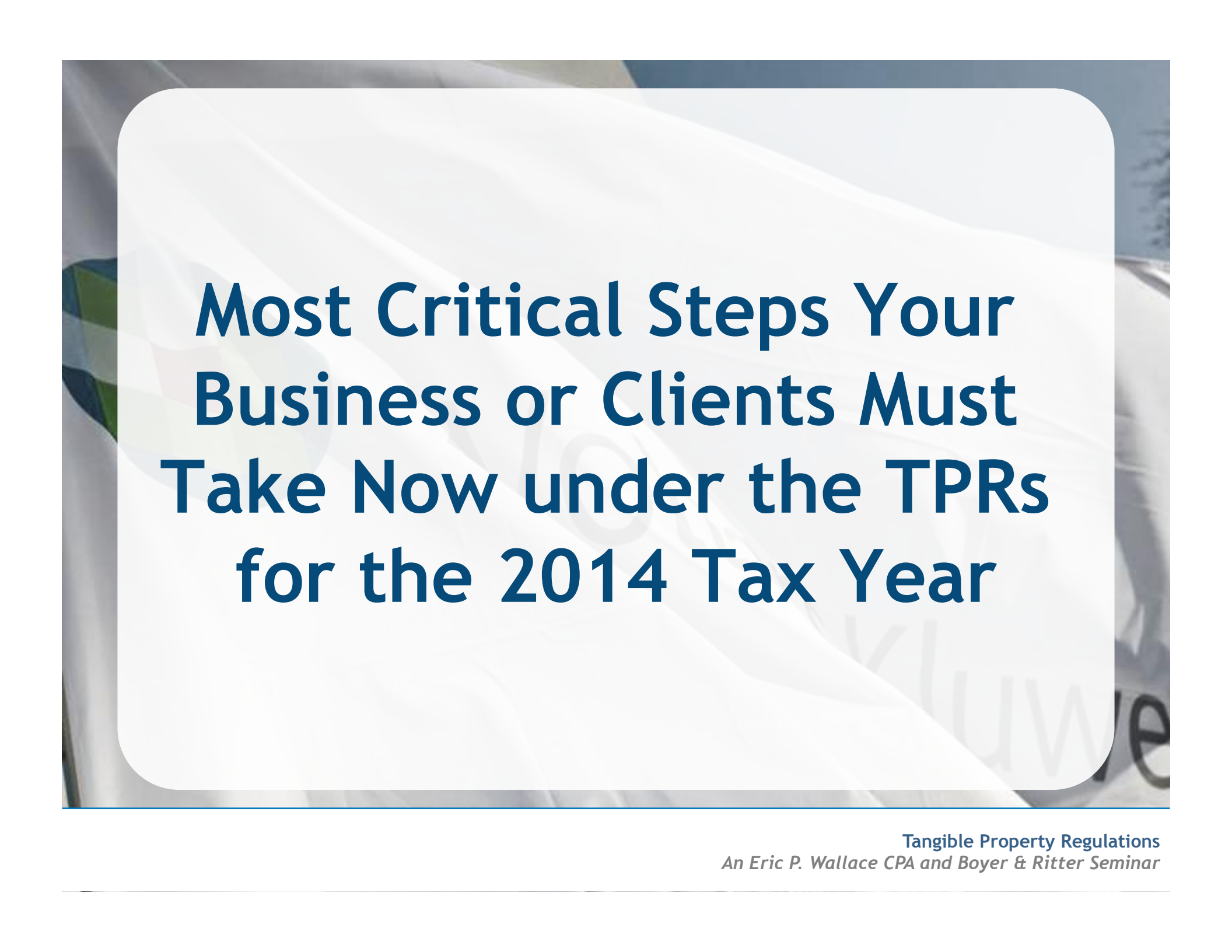
---

- We can do the same example for method #7 as the scope limitation does not apply there either
  - RP 2014-17 also removed the scope limitations of #7 for any asset if related to changing from R & M to capitalizing or vice versa
  - Problem with #7, however, is that impermissible depreciation are subject to the use it or lose it rules ...

# The Potential **Typical** TPR Method Required Filings

---

- ##184, 186, 192 combined, concurrent Form 3115 filing on R & M, R.A.B.I. test, RMSH, Unit of Property and proper cost capitalization (R)
- #7 for impermissible depreciation methods (R)
- #21 for removal costs (O)
- #177 for building partial asset dispositions (PADs) and #178 for PADs o/t buildings (O)
- #196 for the late PAD election to support the #177/#178 filing (R) if you want the 177 481(a)



# **Most Critical Steps Your Business or Clients Must Take Now under the TPRs for the 2014 Tax Year**

# Background

---

- A TP can take advantage of tax method changes (IRS Form 3115) by not waiting until tax year 2014, and filing instead for tax year 2013
  - We can file 2013 up until 9-15-14 for extended calendar TPs
- The TPR implementation generally results in tax deductions for a significant portion of TPs (who have assets with net remaining tax depreciable basis)
  - They will also generally permit TPs to write off more expenditures than what they were accustomed to in prior years and write off of many assets that are on the tax depreciation schedule (i.e., R & M or PADs)

# TPRs Require 3115s and Not Just Implementation

---

- In order to implement the TPRs, TPs must generally file 3115s and cannot just implement the TPRs unilaterally
  - In other words, if what you have been doing in the past does not adhere to the TPRs, your method(s) **must be changed via 3115 filings**
- The TPRs are a very complicated maze with numerous traps, but also many available prizes for TPs—if they “open the right curtains”

# Example of Must-File Adherence

---

- XYZ capitalized a \$15,000 roof expenditure on a \$1M commercial building in 2005
- XYZ has a similar expenditure for 2013 for \$20,000
- XYZ knows that it has to file a 3115 in order to change its method(s) to comply with the TPRs
- XYZ wants to wait until 2014 in order to file its 3115s, but XYZ wants to write off the \$20,000 in 2013

# Example of Must-File Adherence

---

**Q:** Can it?

**A:** No

Not in 2013 unless XYZ files a 3115 in order to change its R & M verses capitalization methods

If XYZ does it must write off the prior remaining basis of the 2005 R & M, and any other R & M items on the depr. schedule as a 481(a)

**Note**

XYZ must file a 3115 by 2014 for R & M items (#184)



# Example of Optional 3115 Filings

---

- XYZ also has another \$1M building
- In 2010 it capitalized a \$200,000 roof expenditure as a new roof on a building it purchased in 2002
- The old roof cost \$20,000 to remove and the \$200,000 capitalized includes that cost



# Example of Optional 3115 Filings

---



**Q:** Does XYZ have to file a 3115 in order to write off the 2002 roof partial asset disposition (PAD) in 2010?

In order to comply with the TPRs?

Can XYZ file this in 2013?

Or 2014?

What about the removal costs?

# Example of Optional 3115 Filings

---

**A:** A prior year PAD and/or the write off of removal costs are not required, they are optional

So if XYZ wants to do the 2010 PAD in 2013, it has to file a 3115 with its 2013 return

Those 3115s will be filed separately under methods #177 and #196 (#177 is filed to take the 481(a) and #196 is filed to do the late PAD election)

If XYZ wants to use the 2010 PAD in 2014 it can [How? The final Rev. Proc. that covers this is not released yet]

If XYZ wants to deduct the \$20k of removal costs, it has to file #21 and take a 481(a) on the net remaining tax basis.

**Note:** If the roof PAD was done in 2013, 2014 or after, XYZ could file using the PAD annual election instead

---

# Understand What Happens When a TP Files a 3115

---

- The purpose of a 3115 filing is to
  - First: Change a TP's particular tax method of accounting
    - These are automatic if they have been assigned a method number by the IRS
  - Second: Catch up for the accounting method change difference between the prior method and the proposed method that the TP is changing to (this is the 481(a) adjustment)
- You have to know which TPR method changes are mandatory and which ones are optional

# Practice Tips

## *Determine the Effects of the TPRs—Group A*

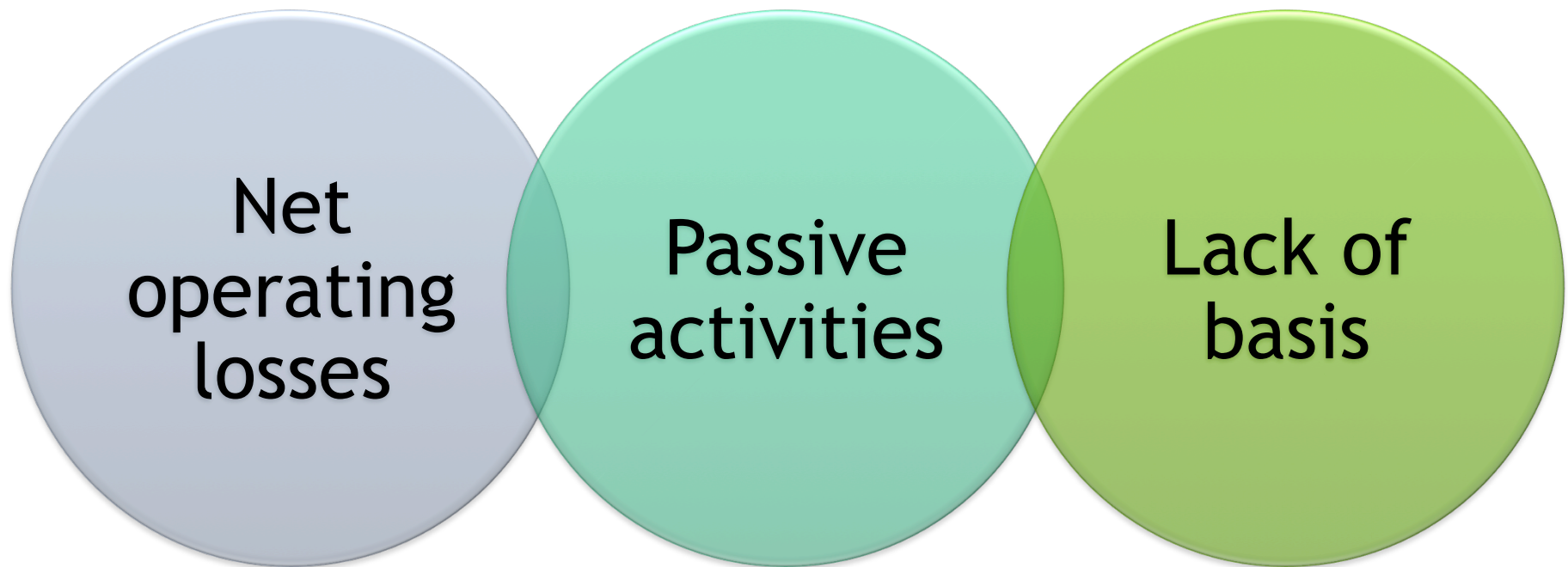
---

- Group your clients—for example
  - For large businesses or clients, you will be required to embrace the TPRs fully
    - Determine which tax year(s) to do the TPR efforts
      - Do whatever methods you can for tax year 2013 (if the return is extended or a fiscal year filer) and data for that year is available
      - It must be no later than tax year 2014 for all taxpayers
      - Focus first on getting the data that will take time to gather

# Determine or Estimate the Effects of the TPRs—Group C

---

- For small 1040s or businesses or clients that have the following attributes, plan on only doing what is the minimum required TPR efforts



# Group B

---

- For businesses or clients that fall outside of these two groups, do the same procedures as for Group A, just plan on doing them after you take care of Group A
- Organization and monitoring of your TPR efforts is essential



# Minimum Required TPR Efforts—Two

---

- Learn and know what the “minimum required TPR efforts” are and when they are due
  - File required or must-do method changes as late as possible (tax year 2014)
    - These would be any methods that result in
      - No 481(a) adjustments,
      - A positive 481(a) adjustment, or
      - No current tax benefits



# Beneficial Methods for 2013-14?

---



- File beneficial method changes first
  - File for 2013 if that year is not yet filed
  - Beneficial method changes are those that provide tax deductions for the taxpayer
    - i.e., negative 481(a)s

# Know the Retrospective or Prospective Accounting Method Changes

---

- Know which method changes can go back in time to all prior tax years (i.e., negative 481(a)s), **if the taxpayer is required—or wants—to include prior year adjustments** (and not just do accounting method change(s))



# Know the Retrospective or Prospective Accounting Method Changes—Three

---

Class life or Bonus impermissible methods (REQUIRED) [#7]

Repair items capitalized in prior years that if now viewed under the final TPRs did not have to be capitalized (REQUIRED) [#184]

Routine maintenance safe harbor (OPTIONAL) [#184]

Prior year asset disposition(s) (OPTIONAL) [#177, #178, #196, #197]

Removal costs (OPTIONAL) [#21]

Prior-year leaseholds to write off (REQUIRED) [#107]

Unit of property changes/corrections (REQUIRED) [#184 or #177/178]

# TPR

## *Accounting Method Changes*

---

- Know which method changes cannot go back in time (i.e., cannot be filed for tax years prior to 2014 (or 2012))
  - M & S changes [#186 for incidental and #187 for non-incidental]
  - DMSH [current year election and/or amended return only for 2012 or 2013 within 180 days after filing]
  - SHST [same as above]
- Know which method changes only apply to transactions made after 1-1-12 (1-1-14)
  - Same methods as listed above

# TPR

## *Accounting Method Changes*

---

- 🌐 Know which #3115 method changes that are retrospective *and* which ones **must be filed**
  - Impermissible depreciation methods [#7]
    - Class lives or bonus
  - Repair & Maintenance capitalized items [#184]
  - Unit of property corrections [but not PADs (#184 and/or #177/178)]

# TPR Elections

---

- Know which items of the TPRs are elections and NOT accounting method changes, and/or that can be elected for tax returns for 2012/13 or 2014 as elections
  - Partial asset dispositions, DMSH, SHST

# All of the Method Change or Election Rules in Visual Form

---

- Let's go over the details of all of these methods
- These are eight different required and/or optional ways
- The next slide does **not** include the impermissible depreciation method changes
- The next slide may be changed/revised when the IRS releases the final MACRS disposition regs and method changes

## Visual Chart of Applicable Dates for Final & Proposed TPR Sections

Final Regulation Issues	2009 & Prior	2010	2011	2012	2013	2014	2015	2016 & After	Final or Proposed TPR Method Change #s)	Required or Optional
Material & Supplies (1.162-3(a))				2		1			186, 187	R
Material & Supplies, election to capitalize (1.162-3(d))				3		4			N/A - election	O
Rotable & Temporary Spare Parts (1.162-3(e))				5		6			188, 189	R
Repairs (1.162-4)				5		6			184	R
Leased Property (1.167(a)-4)				5		6			175, 199	R
Amts paid to sell property (1.263(a)-1(e))				5		6			190, 191	R
De minimis safe harbor election (1.263(a)-1(f))				3		4			N/A - election	O
Acquired or produced tangible property (1.263(a)-2(d))				5		6			192	R
Defense or perfection of title to property (1.263(a)-2(e))				5		6			192	R
Capitalization of Transaction Costs (1.263(a)-2(f))				3		4			192, 193	R
Recovery of capitalized amounts (1.263(a)-2(h))				5		6			192	R
Capitalize amts paid for improvements (1.263(a)-3(d))				5		6			184	R
Unit of Property (1.263(a)-3(e))				5		6			184	R
Improvements to leased property (1.263(a)-3(f))				5		6			184	R
Special rules for determining improvement costs (1.263(a)-3(g))				5		6			21, 184	O
Safe harbor for small taxpayers (1.263(a)-3(h))				3		4			N/A - election	O
Safe harbor for routine maintenance (1.263(a)-3(i))				5		6			184	O
Capitalization of betterments (1.263(a)-3(j))				5		6			184	R
Capitalization of restorations (1.263(a)-3(k))				5		6			184	R
Capitalization - adaptations (1.263(a)-3(l))				5		6			184	R
Optional regulatory accounting method (1.263(a)-3(m))				3		4			185	O
Election to capitalize repair and maintenance costs (1.263(a)-3(n))				3		4			N/A - election	O
<b>Proposed Regulation Issues</b>										
Accounting for MACRS property (1.168(i)-7)				5		6			176,180,200	O
Disposition of a portion of an asset (1.168(i)-8(d)(2))		5		7		8			election &/or #177/178/196	O

**Color Codes:**

1	= common issues to address
2	3115 Accounting Method Change: Must apply to amounts paid on or after January 1, 2014
3	Prospective 3115 - Can choose to apply to amounts paid on or after January 1, 2012
4	No 3115 - Election to apply to tax years 2012 or 2013 by amended tax return, or on 2013 by election statement
4	No 3115 - Election to apply to tax years 2014 and after, year by year election statement attached to return
5	Retroactive 3115 Accounting Method Change: can be applied to tax years before 2012
6	3115 Accounting Method Change: Taxable years beginning on or after January 1, 2014
7	Amended Return - Apply by amended return within 180 days after year end or on 3115 for following year
8	Elect annually by completing applicable forms and taking gain/loss on asset disposed of



# Gather the Information Needed

---

- Obtain an understanding of the business processes with respect to fixed assets, M & S, capitalization, R & M, and depreciation methods used, and/or the allocation of depreciation
- Obtain the capitalization policy that is in place
  - If not in place, get it “in place”
    - Also modify ones in place

# Gather the Information Needed

---

- Obtain the fixed asset schedules for tax purposes
  - Make sure you get the applicable tax year
    - i.e., 12-31-12 for a 3115 for tax year 2013, or 12-31-13 for tax year 2014 filing
  - Get them into Excel form for the required analysis and
  - Calculation of the 481(a) adjustment(s)
  - Tracking of your conclusions

# Supporting Data—Gather

---

- Gather the supporting data
  - The data that will support your 481(a) adjustments needed to complete the schedules that must be attached to the 3115 for its 481(a) adjustments
  - This is the most time consuming part of the TPR implementation
- The TP has the burden of proof in making changes
  - Is the description enough on the TP depreciation schedule to enable the CPA to
    - Change class lives or correct bonus?
    - Write off an item as a R & M? or as RMSH? Partial asset disposition?
  - Does the lack of description require the CPA to get source documents?
- *If the TP cannot prove the change, it cannot make the change*

# Supporting Data—Prepare Schedules to Attach to 3115

---

- Prepare the supporting data (that must be attached to the 3115 for its 481(a) adjustments) and 3115s to comply with the new TPRs to
  - Get the taxpayer’s accounting method(s) changed to the new TPR requirements
  - Get (chosen) negative 481(a) adjustments (adjustments that reduce the TP’s income)
    - Generally reported as a deduction in the current (i.e., the year the 3115 is filed) year
    - There also is “magic” to the netting of 481(a) adjustments
  - Also report positive 481(a) adjustments (adjustments that increase income)
    - Generally reported over the current year and future three years

# Amounts Paid to Acquire or Produce Tangible Property

## Note

These rules cover the situations where a TP buys an asset. This is not a section addressing the R.A.B.I. Rules

# Amounts Paid to Acquire or Produce Tangible Property

---

- This is the relatively easy part of the TPRs as it relates to both real or personal property for what a taxpayer buys or constructs (not improves)
  - If you buy, it tells you what types of costs you have to capitalize
  - If you construct you have to capitalize the costs according to the costing rules of 263A

# §1.263(a)-2(d)

## *Requirement to Capitalize*

---

- TP must capitalize amounts paid to acquire or produce a Unit of Property (U of P), including leasehold improvements, land and land improvements, buildings, machinery and equipment, and furniture and fixtures
- Amounts paid = invoice price, transaction costs, and costs for work performed prior to the date that the U of P is placed in service by the TP
  - Must also capitalize amounts paid to acquire real or personal property for resale
- These rules are superseded, if applicable, if M & S and/or the DMSH apply

# §1.263(a)-2(d)

## *Requirement to Capitalize*

---

### Example 2

- Billy Bob purchases a building that he intends to use in his business
- Before the building is placed in service, Billy has to replace the roof and replace all of the windows in the building





# §1.263(a)-2(d)

## *Requirement to Capitalize*

---

### Question

- What affect does the partial asset disposition election have on these disposals?

### Answer

- NONE, Why?
  - These are all costs that were for work performed prior to the date the U of P was placed in service by the TP
  - All of these replacement costs must be capitalized and no loss can be realized on the disposed of assets

# 2(e) Defend or Perfect Title to Property

---



- Amounts paid to defend or perfect title must be capitalized
  - The following are examples of such
- Example: X spends legal \$ to fight property condemnation

# 2(f) Transaction Costs

---

- TP must capitalize amounts paid to facilitate the acquisition of real or personal property
  - §1.263(a)-5 talks about \$ paid to facilitate the acquisition of assets that are a trade or business
- Definition
  - Amount paid for process of investigating or otherwise pursuing the acquisition of property

# 2(f) Transaction Costs

---

- Determined by all facts and circumstances
- Fact that amount paid would or would not have been paid but for the acquisitions is relevant but not determinative
- Costs include “inherently facilitative” amounts



## 2(f)(3) Treatment of Transaction Costs, Facilitative and Inherently Facilitative

---

- Facilitative must be capitalized in basis of property acquired
- Inherently facilitative amounts must be capitalized even if property is not eventually acquired
  - Can write off later under section 165 (losses), 167 (amortization), or 168 (depreciation)

# 2(f)(ii)

## Inherently Facilitative Amounts

tax advice  
architectural  
environmental title examination permits  
sales and transfer taxes title registration  
qualified intermediary charges legal  
finders or brokers fees or commissions  
survey  
application fees obtaining regulatory approval  
engineering bidding costs  
inspection geological  
appraisal Shipping  
moving

# 2(f)(iv)

## *Employee Compensation and Overhead Costs*

---

- Amounts paid for employee compensation and OH are treated as amounts that do not facilitate the acquisition of real or personal property
- A TP may elect to capitalize these as amounts that are facilitative annually
  - How? Just capitalize the costs
  - That means that a TP who does not know the difference between costs that do or do not facilitate the acquisition of property and who capitalizes all costs, cannot go back later and correct his or her mistake

# 1.263(a)-2(i) Effective/ Applicability Dates

---

- Effective for tax years beginning on or after 1-1-14, except for the following where it applies to *transactions* on or after 1-1-14
  - (f)(2)(iii) Special rule for acquisitions of real property
  - (f)(2)(iv) Election to capitalize employee compensation and overhead
  - (f)(3)(ii) Treatment of inherently facilitative amounts



# 1.263(a)-2

## Accounting Method Changes

- All of the methods under 1.263(a)-2, except for electing to capitalize facilitative costs, are a change in method of accounting
  - Why?
    - IRS is in charge of method change under 446
    - IRS requires a 481(a) adjustment to implement this section



# TPR Method Changes



# Understand What Happens When a TP Files a 3115

---

- The purpose of a 3115 filing is to
  - First: Change a TP's particular tax method of accounting
    - These are automatic if they have been assigned a method number by the IRS
  - Second: Catch up for the accounting method change difference between the prior method and the proposed method that the TP is changing to (this is the 481(a) adjustment)
- You have to know which TPR method changes are mandatory and which ones are optional

# What is the Complete 3115 Package?

---

1. The completed 3115
2. Attachment to the 3115 - answers all of the questions, provides the supporting statements
3. The 481(a) adjustment schedule
4. The POA
5. The schedule of related party 3115s filed and by what entities

Example XYZ, Inc.

12-3456789

3115 481(a) Adjustment, Automatic Method #7

Automatic Method #7, IRS Form 3115, Change in Accounting Method  
Impermissible to Permissible Method for Depreciation and Amortization

Asset Description*	Year of Addition	Original Life	Correct Life	Original Cost	A/D Taken through 12/31/2012	Corrected A/D through 12/31/2012	Negative 481(a) Adj	Positive 481(a) Adj
<i>Personal Property:</i>								
NETWORK FIREWALL	2008	5	3	6,491	6,180	6,491	311	-
SECURITY SYSTEM	2012	7	39	5,427	3,101	6	-	3,096
SIGN	2006	7	5	1,800	1,720	1,800	80	-
MERCHANDISE LOT LIGHTS (3)	2005	15	5	8,811	4,909	8,811	3,902	-
IT SOFTWARE FOR SALES DEPT SECTION 197 INTANGIBLES	2010	5	3	2,701	2,312	2,601	289	-
	2001	15	15***	1,818,818	1,442,920	1,394,427	-	48,493
							-	-
<b>Subtotal</b>				1,844,047	1,461,141	1,414,135	4,582	51,589
<i>Leasehold improvements on real property:</i>								
FIELD DOCK FOR TRAILERS	2002	15	39	778	633	215	-	418
MACHINERY WRIING	2004	39	7	23,335	4,911	23,335	18,424	-
FRENCH DRAIN PARKING LOT	2006	39	15	7,485	1,320	6,367	5,048	-
FENCING	2011	7	15	7,065	7,065	7,065	-	-
LEASEHOLD IMPROVEMENTS	2010	39	15**	26,768	26,768	26,768	-	-
<b>Subtotal</b>				65,432	40,697	63,751	23,472	418
<b>Adjustments due to incorrect class lives</b>				<b>1,909,479</b>	<b>1,501,839</b>	<b>1,477,886</b>	<b>28,054</b>	<b>52,006</b>

*Net Positive 481(a) Adjustment*

**23,953**

\* All equipment is utilized in RP 87-56 Activity 57.0

\*\* Qualified leasehold improvement property

\*\*\*Intangible was amortized using 150% instead of straight line

Example XYZ, Inc.

12-3456789

3115 481(a) Adjustment, Automatic Method #162

Change in Accounting Method, #162 Change to properly deducting repair and maintenance items

Asset Description*	Year of Addition	Original Life	Original Cost	A/D Taken through 12/31/2012	Net Tax Remaining Basis 12/31/2012	Negative 481(a) Adjustment
<i>Equipment and personal tangible property:</i>						
SALES DEPT 2 TON A/C UNIT	2009	39	3,998	363	3,635	(3,635)
AIRCOMPRESSOR PUMP	2012	5	4,580	2,748	1,832	(1,832)
OVERHEAD INFRARED HEATERS	2012	5	12,280	7,368	4,912	(4,912)
<b>Subtotal</b>			20,858	10,479	10,379	(10,379)
<i>Leasehold improvements on real property:</i>						
WOMENS ROOM	4/30/08	39	4,396	531	3,865	(3,865)
LIGHTING RETROFIT	8/31/11	39	9,695	342	9,353	(9,353)
SECURITY ALTERATIONS	10/01/91	40	2,067	1,096	971	(971)
WOOD DECK & STEPS	6/30/00	39	875	281	594	(594)
OVERHEAD DOOR INSTALLATION	2/01/90	32	2,764	2,007	757	(757)
CONCRETE SHOP FLOOR	6/30/08	5	4,186	4,168	19	(19)
TRENCH & GRADE	4/01/86	19	1,558	1,539	19	(19)
RELOCATE HEATER	11/30/07	39	3,500	460	3,040	(3,040)
FRENCH DRAIN	6/30/98	39	3,382	1,261	2,121	(2,121)
ADDIT STONE PARKING LOT - LEVEL	7/31/10	15	3,246	1,997	1,249	(1,249)
NEW RETAINING WALL	1/31/11	39	3,800	191	3,609	(3,609)
<b>Subtotal</b>			39,470	13,872	25,597	(25,597)
<b>Adjustments due to incorrect class lives</b>			<b>60,328</b>	<b>24,352</b>	<b>35,976</b>	<b>(35,976)</b>
<b>Net Negative 481(a) Adjustment</b>						<b>(35,976)</b>

\* All assets are utilized in RP 87-56 Activity 57.0

# What order should items on the depreciation sch. be organized?

- Recommendations:
  - 1. dump the tax depr. Schedule to Excel
  - 2. organize the depr. Schedule so that you are only reviewing the assets that have remaining tax basis
    - It is important to review other items fully depreciated, but I have found that TPs have few assets where they erred on too short of class lives
- Recommendation: for buildings:
  - Group by buildings
  - Group by new assets first to oldest
- 3. Create “codes” so you can group like kind changes



# The specific TPR potential changes - Use Codes to Accumulate

- (R) Items capitalized that should not have (R & M)
- (RV) Removal (also demo, moving, relocation) costs
- (CL) Class lives that are incorrect
- (B) Bonus that was taken or not
- (P1 or P2) Partial or prior assets disposed of
- (RM) Routine maintenance
- (SV) Salvage values but assets were disposed of
- (IM) Incidental materials capitalized and being depreciated (but not apply to transactions >1-1-12)
- (L) Leaseholds continued to be depreciated but assets are gone
- (A) Abandoned assets still being depreciated
- (D) Data is needed from client (use this for all above)



# The Potential Typical TPR Method Required Filings

---

- #184, 186, 192 combined, concurrent Form 3115 filing on R & M, R.A.B.I. test, RMSH, Unit of Property and proper cost capitalization (R)
- #7 for impermissible depreciation methods (R)
- #21 for removal costs (O)
- #177 for building partial asset dispositions (PADs) and #178 for PADs o/t buildings (O)
- #196 for the late PAD election to support the #177/#178 filing (R) if you want the 177 481(a)

# 184, 186, 192 Combination

---

- #184, due by 2014, is the method that enables a taxpayer to adopt:
  - R & M of 1.162-4 and take a 481(a) adjustment for all prior R & M that should not have been capitalized, as now viewed under the final TPRs
  - RMSH of 1.263(a)-3(i)
  - Unit of Property of 1.263(a)-3(e)
  - The “R.A.B.I.” rules of 1.263(a)-3
- A #184 filing must cite the applicable regulation section(s) - about 50 potential cites!

# 184, 186, 192 Combination

---

- #186 is the method that enables a taxpayer to adopt:
  - The write off of units of property \$200 and under
  - The Non-incident material and supplies method change
  - This one is for transactions 1-1-14 and after (or 1-1-12), so typically will not have a section 481(a) adjustment
  - #187 is the incidental M & S rule

# 184, 186, 192 Combination

---

- 🌐 #192 is the method that enables a taxpayer to adopt:
  - The proper capitalization of 1.263(a)-2 for assets purchased or produced
  - Example: you must capitalize all facilitative and inherently facilitative costs
  - Inherently facilitative costs are specifically defined in 1.263(a)-2(f)(ii)

# Next Required Method = #7

---

- Method #7 for any impermissible to permissible depreciation changes for:
  - Class lives that are not correct
  - Bonus that was done right
  - Assets that were depreciated that should not have been and vice versa
- See RP 87-56 for common class lives to assets employed in various Activities
- Risk of not filing? IRS use of the “use it or lose it” rule, as now authorized by 1.1016-3

# First Optional is #21

---

- A method #21 filing enables a taxpayer (TP) not to have to capitalize any prior or future removal costs associated with an improvement (i.e. a R.A.B.I.) - why not file for all TPs?
- A TP must also have a PAD on the prior asset disposed of (whether current year or prior)
- can choose each time to employ not
- Not due by 2014 but if a TP wants not to have to capitalize removal costs, it must file this method change

# PAD for Buildings for Prior Years is #177

---

- A method #177 filing enables a TP to write off all duplicate assets that it currently has on its depreciation schedule
- TP can use any “reasonable method” to calculate the basis of those assets including:
  - PPI roll back method
  - Factorial comparison
  - Cost segregation

# Method Changes

## *What We Know to Date and How to Do Them*

---

- As the final MACRS disposition regulations did not change much of the proposed MACRS disposition regulations, and since the IRS added new language into the 1.168(i)-8(d)(2) section as follows, we are assuming that the final method changes will be similar to the proposed method changes
  - Except as provided in paragraph (d)(2)(iii) [i.e., Special rule for subsequent Internal Revenue Service adjustment] or (iv)(B) [an application for change in accounting method with the taxpayer's timely filed original 2013 (for 2012) or 2014 (for 2012 or 2013) return] of this section **or except as otherwise expressly provided by other guidance published in the Internal Revenue Bulletin (see §601.601(d)(2) of this chapter**, the election specified in paragraph (d)(2)(i) of this section may not be made through the filing of an application for change in accounting method
- We are also assuming that the method changes of RP 2014-17 will just be modified by the IRS to permit prior year PADs in tax year 2014



# PAD for Non-Building Prior Years is #178

---

- Same rules as #177 but this one applies to assets other than buildings, such as land improvements
- Cannot file a #177 and a #178 on the same 3115 form
- #177, #178 and #196 are only good (currently) through tax year 2013 [when the F MACRS Disposition rules are issued - may be same #s]

# Final Typical TPR Method is #196

---

- A #196 filing is the late PAD election to support the 481(a)s taken under method #177 and/or #178
- Without a #196 filing, a TP will be required to reverse the 481(a)s taken under #177 and/or #178
- The #196 does not provide the taxpayer with the gain or loss recognition (see #177 or #178 for that)

# Why the TPRs Are Unique

---

- TPs and their preparers are not accustomed to being required to file accounting method changes whenever a new regulation is released
  - While the new annual elections are excluded, the Sections 1.162-3(i), 1.162-4(b), 1.263(a)-1(g), 1.263(a)-2(i), and 1.263(a)-3(q) of the final TPRs state that a TP seeking to change to a method of accounting provided in the final TPRs must secure the consent of the Commissioner
- They are also retroactive for many of the changes

# Other 3115 Parameters

---

- If the TP has not yet placed an asset in service and is fixing it up, and/or takes an asset out of service to “fix it up,” a TP cannot have a partial asset disposition—all expenditures have to be capitalized
- The final, temporary and/or proposed regulations do not override any treatment required for demolition losses under Code Sec. 280B
  - Those have to be capitalized as part of the land costs

# Properly Prepare and File the 3115s

---

- Generally, each separate trade or business and each separate LLC must file its own 3115s or sets of 3115s

## Example

An individual with 10 disregarded LLCs must file separate 3115 forms for each of the LLCs

# Properly Track TPR Efforts or Needs

---

- 🌐 The preparer must be aware and maintain records on
  - What 3115s were filed for what tax years
    - Were those 3115s mailed to the proper addresses as either copies or originals, as required?
    - Were those 3115s copies or originals attached to the tax returns?
  - What the 481(a) adjustments were for every method filing
    - What positive 481(a)s needed to be carried over and reported on future tax return filings?
    - Whether the TP properly reported and calculated the net of the 481(a) adjustments

# CONCLUSION