Tangible Property Regulations

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A. Introduction

1. Culminating a process that began nearly a decade ago, Treasury and the IRS have finalized the tangible property regulations first proposed in 2006, again in 2008, and reissued as temporary and proposed regulations in December 2011.

2. The final regulations were published on September 19, 2013, and August 18, 2014.

    a. TD 9636 - Guidance Regarding Deductions and Capitalization of Expenditures Related to Tangible Property

    b. TD 9689 - Guidance Regarding Disposition of Tangible Depreciable Property

3. The final regulations are designed to apply to nearly all costs a taxpayer incurs in connection with tangible property.

4. The regulations apply to costs incurred throughout the entire life cycle of the taxpayer's tangible property, from the time the taxpayer (1) first begins considering whether (and which) property to acquire, (2) through maintaining and improving the property during its operational life, and (3) finally to the treatment of the property's remaining basis when the taxpayer disposes of the property.

    a. The final regulations seek to provide guidance for each of these three phases of expenditures.

5. Section 263(a) generally requires the capitalization of amounts paid to acquire, produce, or improve tangible property. Section 162 allows a deduction for all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including the costs of certain supplies, repairs, and maintenance.

6. An analysis of costs to repair or improve tangible property in prior years is required to conform to the final tangible property regulations.

    a. Taxpayers who previously deducted expenses that should have been capitalized under the rules for betterments, restorations, and adaptations are required to change their accounting method and compute a positive (unfavorable) Sec. 481(a) adjustment equal to the difference between the deducted amount and the amount of any depreciation that could have been claimed on the deducted amount if it had been capitalized prior to the year of change.

        1) Changes include a change to capitalize and, if applicable, a change to depreciate the capitalized amount. A change to the definition of a unit of property may also be required.

7. On February 10, 2014, a US Treasury Department official indicated that businesses should file Form 3115 to indicate their compliance with the new regulations, even if they are already operating in compliance with the regulations. Thus, it is possible that taxpayers could file Form 3115 with a zero 481(a) adjustment, indicating that there is no negative or positive impact on that taxpayer's income for that tax year. What this means for taxpayers is that they should consider filing these 3115s proactively, even if they are already acting in compliance with the regulations.

8. The IRS has provided a number of accounting method changes that come with automatic approval and no user fee for 2014.

    a. Many of the accounting method changes will have a $7,000 user fee starting with the 2015 tax returns.

9. With the new regulations effective for tax years beginning on or after Jan. 1, 2014, almost every federal tax return for businesses that own tangible property should have at least one Form 3115 or an election statement that the taxpayers will need to file to adopt the rules under the final regulations. For example, taxpayers will need to file a Form 3115 to adopt the materials-and-supplies provision or file an election statement to use the de minimis rules. Failure to include the Form 3115 or election statement may indicate either an unauthorized accounting method change (one that did not obtain the IRS's required consent) or the taxpayer's noncompliance with the final regulations.

    a. All practitioners should be "scrubbing" their client's depreciation schedules for possible accounting changes and making these method changes if the client is not in compliance with the final regulations.

10. There will be fewer book/tax differences after the tangible property regulations.

B. Acquisition Costs

1. De Minimis Costs

    a. The final regulations provide an elective $5,000/$500 per-item book-conformity safe harbor. [Reg. 1.263(a)-1(f)]

    b. For taxpayers having an Applicable Financial Statement (AFS), the safe harbor requires a written de minimis policy consistently applied for financial accounting purposes under which the taxpayer deducts either items costing less than a stated dollar amount or items having an economic useful life of 12 months or less. [Sec. 1.263(a)-1(f)(1)(I)]

        1) The written book policy must be in place as of the first day of the tax year. [Reg. 1.263(a)-1(f)(i)(B)]

    c. Applicable Financial Statement Defined

        1) An "applicable financial statement" is defined as:

            a) A financial statement required to be filed with the Securities and Exchange Commission (SEC) (the 10-K or the Annual Statement to Shareholders);

            b) A certified audit financial statement that is accompanied by the report of an independent certified public account (or in the case of a foreign entity, by the report of a similarly qualified independent professional) that is used for (a) credit purposes; (b) reporting to shareholders, partners, or similar persons; or (c) any other substantial nontax purpose; or

            c) A financial statement (other than a tax return) required to be provided to the federal or a state government or any federal or state agency (other than the SEC or the Internal Revenue Service) [Reg. 1.263(a)-1(f)(4)].

2) A taxpayer may have more than one of the preceding applicable financial statements. For purposes of applying the de minimis rule, the statement in the highest category (i.e., item (a) being the highest) is treated as the AFS. This will be treated as the statement for which a written accounting procedure must be in effect [Reg. 1.263-1(f)(4)].

3) If the taxpayer's financial results are reported on the AFS for a group of entities, then the group's AFS may be treated as the AFS of the taxpayer, and the written accounting procedures provided for the group and utilized for the group's AFS may be treated as the written accounting procedures of the taxpayer [Reg. 1.263(a)-1(f)(30(vi)].

4) Reviewed financial statement as defined in the AICPA's Statement of Standards for Accounting and Review Services do not qualify as applicable financial statements.

d. For smaller taxpayers not having an AFS, the de minimis amount is reduced from $5,000 to $500 per item. [Sec. 1.263(a)-1(f)1)(ii)]

1) The book policy need not be written.

2) The policy need to be known within the organization as an accounting procedure/policy even if not written.

3) It is suggested that the policy be written, even if not required.

e. The final regulations permit the taxpayer to deduct for tax purposes any amount deducted under its book policy that does not exceed $5,000/$500 per invoice (or per item, as substantiated by the invoice).

f. When an item is acquired as part of a bulk purchase, the taxpayer may use a reasonable method to allocate the total invoice price among the items acquired as part of that invoice.

1) Reasonable allocation methods include, but are not limited to specific identification, a pro rata allocation, or a weighted average method based on the property's relative cost.

g. Taxpayers having written policies under which amount greater than $5,000/$500 are deducted for books purposes remain eligible to elect the de minimis safe harbor.

1) For example, when the taxpayer's book policy deducts new purchases costing less than $10,000 per item, the safe harbor will apply to expenditures for items costing no more than $5,000. Items costing between $5,000 and $10,000 that are deducted for book purposes potentially may still be deducted for tax purposes.

2) Taxpayers whose book policies exclude specific categories of items from the general standard remain entitled to deduct under the de minimis safe harbor those items that are in fact consistently expensed for book purposes.

h. The aggregate amount deducted as de minimis costs during a year is no longer relevant.

i. Transaction costs must be included in applying the de minimis safe harbor if those costs are reflected on the same invoice. [Reg. 1.263(a)-1(f)(3)(i)]

j. Use of the de minimis safe harbor is not an accounting method.

1) This safe harbor requires an annual, irrevocable election.

2) The election is made by attaching a statement to the taxpayer's timely filed original return (including extensions) for the year in which the amounts are paid. [Reg. 1.263(a)-1(f)(5)]

a) The statement must be titled "Section 1.263(a)-1(f) de minimis safe harbor election" and include the taxpayer's name, address, taxpayer identification number, and a statement that the taxpayer is making the de minimis safe harbor election under § 1.263(a)-1(f). [Reg. 1.263(a)-1(f)(5)]

b) No Form 3115 is required for making the election.

k. The de minimis safe harbor also applies to repair and maintenance expenses costing no more than $5,000/$500 that are deducted for book purposes.

1) For example, if the taxpayer pays a total of $4,000 in parts and labor to repair a malfunctioning piece of equipment, the de minimis safe harbor will apply to the entire $4,000 payment.

a) That cost would still need to be tested under Sec. 263A to determine if it must be capitalized under the uniform capitalization rules.

l. Amounts paid for tangible property eligible for the de minimis safe harbor may, nonetheless, be subject to capitalization under Section 263A if the amounts paid for this tangible property comprise the direct or allocable indirect cost of other property produced by the taxpayer or property acquired for resale.

2. Materials and Supplies

a. The definition of materials and supplies includes units of property costing no more than $200.

1) The rule will not affect the taxpayer electing the de minimis safe harbor.

2) Taxpayers electing the materials and supplies safe harbor account for the materials and supplies as materials and supplies safe harbor and not materials and supplies.

b. The final regulations require a taxpayer electing the de minimis safe harbor to apply the safe harbor to amounts paid for all materials and supplies that meet the requirements for deduction under the safe harbor.

c. Incidental Materials and Supplies

1) Incidental materials and supplies are deducted in the tax year their cost is paid or incurred. [Reg. 1.162-3(a)(2)]

2) Incidental materials and supplies are materials and supplies that are carried on hand and for which no record of consumption is kept or for which beginning and ending inventories are not taken.

d. Non-Incidental Materials and Supplies

1) The cost of a non-incidental material or supply is deducted in the year the item is used or consumed. [Reg. 1.162-3(a)(1)]

a) Material or supply for which inventory in kept.

2) The cost of many non-incidental materials and supplies will be deducted under the de minimis safe harbor when the items are purchased, rather than in the year they are used or consumed as under the general rule for non-incidental materials and supplies.

e. Uniform Capitalization Rules Apply

1) Materials and supplies that are used in the production of property are subject to the uniform capitalization rules of Sec. 163A. [Reg. 1.162-3(b)]

f. Rotable and Temporary Spare Parts

1) Rotable and temporary spare parts are first used in the taxpayer's operations or are consumed in the taxpayer's operations in the taxable year in which the taxpayer disposed of the parts.

2) Rotable spare parts are materials and supplies that are acquired for installation on a unit of property, removable from that unit of property, generally repaired or improved, and either reinstalled on the same or other property or stored for later installation. [Reg. 1.162-3(a)[2)]

3) Temporary spare parts are materials and supplies that are used temporarily until a new or repaired part can be installed and then are removed and stored for later installation. [Reg. 1.162-3(a)(2)]

g. Standby Emergency Spare Parts

1) The final regulations add emergency spare parts as a category of materials and supplies. [Reg. 1.162-3(c)(3)]

2) Generally deducted when the part is first used or consumed.

3) Standby emergency spare parts are materials and supplies that are:

a) Acquired when particular machinery or equipment is acquired (or later acquired);

b) Set aside for use as replacements to avoid substantial operational time loss caused by emergencies due to particular machinery or equipment failure;

c) Located at or near the site of the installed related machinery or equipment so as to be readily available when needed;

d) Directly related to the particular machinery or piece of equipment they serve;

e) Normally expensive;

f) Only available on special order and not readily available from a vendor or manufacturer;

g) Not subject to normal periodic replacement;

h) Not interchangeable in other machines or equipment;

i) Not acquired in quantity (generally only one is on hand for each piece of machinery or equipment); and

j) Not repaired or reused.

4) The classic example of an emergency spare part is a spare generator held on site at an electric power plant to avoid service disruptions.

h. Gain on the disposition of a material or supply is ordinary income. [Reg. 1.162-3(g)]

i. Example. In Year 1, A purchases 10 printers at $250 each for a total cost of $2,500 as indicated by the invoice. Assume that each printer is a unit of property. A does not have an AFS. A has accounting procedures in place at the beginning of Year 1 to expense amounts paid for property costing less than $500, and A treats the amounts paid for the printers as an expense on its books and records. The amounts paid for the printers meet the requirements for the de minimis safe harbor. If A elects to apply the de minimis safe harbor in Year 1, A may not capitalize the amounts paid for the 10 printers or any other amounts meeting the criteria for the de minimis safe harbor. Instead, A may deduct these amounts in the taxable year the amounts are paid provided the amounts otherwise constitute deductible ordinary and necessary expenses incurred in carrying on a trade or business.

j. Example. In Year 1, B purchases 10 computers at $600 each for a total cost of $6,000 as indicated by the invoice. Assume that each computer is a unit of property. B does not have an AFS. B has accounting procedures in place at the beginning of Year 1 to expense amounts paid for property costing less than $1,000 and B treats the amounts paid for the computers as an expense on its books and records. The amounts paid for the printers do not meet the requirements for the de minimis safe harbor because the amount paid for the property exceeds $500 per invoice (or per item as substantiated by the invoice). B may not apply the de minimis safe harbor election to the amounts paid for the 10 computers.

3. Election to Capitalize the Cost of any Rotable Spare Part, Temporary Spare Part, or Standby Emergency Spare Part

a. Not covered in this outline

C. Amounts Paid to Acquire or Produce Tangible Property

1. A taxpayer must capitalize amounts paid to acquire or produce a unit of real or personal property, including leasehold improvements, land and land improvement, building, machinery and equipment, and furniture and fixtures. [Reg. 1.263(a)-2(d)]

a. Produce means construct, build, install, manufacture, develop, create, raise, or grow. [Reg. 1.263(a)-2(b)(4)]

2. Amounts paid to acquire or produce a unit of real or personal property include the invoice price, transaction costs, and cost for work performed prior to the date that the unit of property is placed in service by the taxpayer. [Reg. 1.263(a)-2(d)]

3. A taxpayer must capitalize amounts paid to acquire real or personal property for resale. [Reg. 1.263(a)-2(d)]

4. Amounts paid to defend or perfect title to real or personal property are amounts paid to acquire or produce property and must be capitalized. [Reg. 1.263(a)-2-(e)]

5. A taxpayer must capitalize amounts paid to facilitate the acquisition of real or personal property. [Reg. 1.263(a)-2(f)]

    a. An amount is paid to facilitate the acquisition of real or personal property if the amount is paid in the process of investigating or otherwise pursuing the acquisition. [Reg. 1.263(a)-2(f)(2)(i)]

    b. An amount is inherently facilitative if the amount is paid for: [Reg. 1.263(a)-2(f)(2)(ii)]
        1) Transporting the property (for example, shipping fees and moving costs);
        2) Securing an appraisal or determining the value or price of property;
        3) Negotiating the terms or structure of the acquisition and obtaining tax advice on the acquisition;
        4) Application fees, bidding costs, or similar expenses;
        5) Preparing and reviewing the documents that effectuate the acquisition of the property (for example, preparing the bid, offer, sales contract, or purchase agreement);
        6) Examining and evaluating the title of property;
        7) Obtaining regulatory approval of the acquisition or securing permits related to the acquisition, including application fees;
        8) Conveying property between the parties, including sales and transfer taxes, and title registration costs;
        9) Finders' fees or brokers' commissions, including contingency fees
        10) Architectural, geological, survey, engineering, environmental, or inspection services pertaining to particular properties; or
        11) Services provided by a qualified intermediary or other facilitator of an exchange under Section 1031.

    c. An amount paid by the taxpayer in the process of investigating or otherwise pursuing the acquisition of real property does not facilitate the acquisition if it relates to activities performed in the process of determining whether to acquire real property and which real property to acquire. [Reg. 1.263(a)-2(f)(iv)(A)]

    d. Amount paid for employee compensation and overhead are treated as amounts that do not facilitate the acquisition of real or personal property. [Reg. 1.263(a)-2(f)(2)(i)]

        1) A taxpayer may elect to treat amounts paid for employee compensation or overhead as amounts that facilitate the acquisition of property. [Reg. 1.263(a)-2(f)(iv)(B)]

6. Amounts that are capitalized are recovered through depreciation, cost of goods sold, or by an adjustment to basis at the time the property is placed in service, sold, used, or otherwise disposed of by the taxpayer. [Reg. 1.263(a)-2(h)]

7. Example. In Year 1, M purchases a building for use as a business office. Prior to placing the building in service, M pays amounts to repair cement steps, refinish wood floors, patch holes in walls, and paint the interiors and exteriors of the building. In Year 2, M places the building in service and begins using the building as its business office. Assume that the work that M performs does not constitute an improvement to the building or its structural components. The building and its structural components is a single unit of property. The amounts paid must be capitalized as amounts to acquire the building unit of property because they were for work performed prior to M's placing the building in service.

D. Repair Costs

1. Capitalization Safe Harbor

a. The final regulations contain a book-conformity capitalization safe harbor.

b. Under the capitalization safe harbor, the taxpayer may elect to treat as capital expenditures for tax purposes those repair and maintenance cost that it treats as capital improvements on its books and records. [Reg. 1.263(a)-3(n)(1)]

1) If elected, the safe harbor applies to all repair and maintenance cost that the taxpayer incurs during the year that are treated as capital improvements on it books and records.

a) This is an irrevocable election.

2) The capitalization safe harbor by its terms applies only to amounts paid for repairs and maintenance.

c. The book capitalization safe harbor is an annual election rather than an accounting method.

1) The election is made by attaching a statement to the taxpayer's original return for the year in which it incurs the amounts to be capitalized. [Reg. 1.263(a)-13(n)(2)]

2. Major Components/Substantial Structural Parts – Unit of Property

a. While a building is the relevant unit of property, the capitalization standards must be applied not to that unit of property but instead to the building structure and to each of eight separate building systems. [Reg. 1.263(a)-3(e)(2)]

1) The final regulations require that a taxpayer apply the improvement standards separately to the primary components of the building or to any of the specifically enumerated building systems. The primary components of a building generally include walls, partitions, floors, and ceilings, as well as any permanent coverings (paneling or tiling), windows, and doors. The specifically enumerated building systems include (1) heating, ventilation, and air conditioning systems; (2) plumbing systems; (3) electrical systems; (4) all escalators; (5) all elevators; (6) fire protection and alarm systems; (7) security systems; (8) gas distribution systems; and (9) any other systems identified in published guidance.

b. Non-building property generally remains subject to the functional interdependence test.

1) In the case of personal or real property other than a building, all the components that are functionally interdependent comprise a single unit of property. Components of property are 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. The improvement rules are applied at the unit of property level. [Reg. 1.263(a)-3(e)(3)(i)]

2) In the case of plant property, the unit of property is further divided into smaller units comprised of each component (or group of components) that performs a discrete and major function or operations within the functionally interdependent machinery or equipment. [Reg. 1.263(a)-3(e)(3)(ii)B)]

a) Plant property means functionally interdependent machinery or equipment, other than network assets, used to perform an industrial process, such as manufacturing, generation, warehousing, distribution, automated materials handling in service industries, or other similar activities. [Reg. 1.263(a)-3(e)(3)(i)(A)]

c. Taxpayers must further divide the identified units of property into major components and substantial structural parts.

1) Absent an available exception, costs to replace a major component or substantial structural part must be capitalized.

d. A major component is a part of combination of parts that performs a "discrete and critical function." [Reg. 1.263(a)-3(k)(6)(i)(A)]

1) Major components do not include incidental components of the unit of property, even though the component performs a discrete and critical function in the operation of the unit of property.

a) For example, even though a piece of equipment will not operate without a power switch, the power switch is not considered a major component under the regulations. [Sec.1.263(a)-3(k)(7), Ex. 13]

2) Major components do not include a roof's rubber membrane; one of three furnaces within a building's HVAC system, three of 10 roof-mounted units within a building's HVAC system, 30 percent of the wiring within a building's electrical system, or eight of 20 sinks within a building's plumbing system. [Reg. 1.263(a)-3(k)(7), Exs. 15-23]

3) For buildings, replacing a major component also includes replacing a significant portion of the major component. [Reg. 1.263(a)-3(k)(6)(ii)(A)]

e. The smaller the unit of property, the more likely is the requirement to capitalize.

3. Capitalization Standards for Improvements, Betterments, and Adaptions

a. Under the final regulations, an expenditure must be capitalized if it results in a betterment to the unit of property, results in a restoration of the unit of property, or adapts the unit of property to a new or different use. [Reg. 1.263(a)-3(j), (k) & (l)]

b. Betterment

1) Generally, an expenditure results in a betterment if it ameliorates a condition or defect that existed before the acquisition of the property or arose during the production of the property; is for a material addition to the property; or increases the property's productivity, efficiency, strength, etc.

2) Example. A owns an office building that contains a HVAC system. The HVAC system incorporates ten roof-mounted units that service different parts of the building. The roof-mounted units are not connected and have separate controls and duct work that distribute the heated or cooled air to different spaces in the building's interior. A pays an amount for labor and materials for work performed on the roof-mounted units. A must treat the building and its structural components as a single unit of property. An amount is paid to improve a building if it is for an improvement to the building structure or any designated building system. The entire HVAC system, including all of the roof mounted units and their components, comprise a building system. Therefore, if an amount paid by A for work on the roof-mounted units is an improvement (for example, a betterment) to the HVAC system, A must treat this amount as an improvement to the building.

c. Restoration

1) A taxpayer must capitalize as an improvement an amount paid to restore a unit of property, including an amount paid to make good the exhaustion for which an allowance is or has been made. An amount restores a unit of property only if it: [Reg. 1.263(a)-3(k)(1)]

a) Is for the replacement of a component of a unit of property for which the taxpayer has properly deducted a loss for that component, other than a casualty loss;

b) Is for the replacement of a component of a unit of property for which the taxpayer has properly taken into account the adjusted basis of the component in realizing gain or loss resulting from the sale or exchange of the component;

c) Is for the restoration of damage to a unit of property for which the taxpayer is required to take a basis adjustment as a result of a casualty loss, or relating to a casualty event;

d) Returns the unit of property to its ordinarily efficient operating condition if the property has deteriorated to a state of disrepair and is no longer functional for its intended use;

e) Results in the rebuilding of the unit of property to a like-new condition after the end of its class life; or

f) Is for the replacement of a part or a combination of parts that comprise a major component or a substantial structural part of a unit of property.

2) Casualty Losses

a) If the taxpayer reduces the basis of the damaged property following a casualty event, the cost incurred to restore the damage must be capitalized at least to the extent of the basis adjustment.

b) When the costs to restore the damage exceed the amount of the basis adjustment resulting from the casualty, the deductibility of the excess expenditures depends of whether the activity constitutes a betterment, restoration, or adaptation of the property to a new or different use under the generally applicable capitalization standards.

(1) If not, the excess costs generally would be deductible as repairs under Section 162(a). [Reg. 1.263(a)-3(k)(4)]

c) The costs required to be capitalized under the casualty loss rule are limited to the excess of (1) the taxpayer's basis adjustments resulting from the casualty event, over (2) the amount paid for restoration of damage to the unit of property that also constitutes a restoration under the other criteria. Casualty-related expenditures in excess of this limitation are not treated as restoration costs and may be properly deducted if they otherwise constitute ordinary and necessary business expenses.

d) Example. C owns a building that it uses in its trade or business. A storm damages the building at a time when the building has an adjusted basis of $500,000. C determines that the cost of restoring its property is $750,000, deducts a casualty loss under Section 165 in the amount of $500,000, and properly reduces its basis in the building to $0. C pays a contractor $750,000 to repair the damage to the building. The work involves replacing the entire roof structure of the building at a cost of $350,000 and pumping water from the building, cleaning debris from the interior and exterior, and replacing areas of damaged dry wall and flooring at a cost of $400,000. Although resulting from the casualty event, the pumping, clearing, and replacing damaged drywall and flooring, does not directly benefit and is not incurred by reason of the roof replacement. C must capitalize as an improvement the $350,000 amount paid to the contractor to replace the roof structure because the roof structure constitutes a major component and a substantial structural part of the building unit of property. In addition, C must treat as a restoration the remaining costs, limited to the excess of the adjusted basis of the building over the amounts paid for the improvement. Accordingly, C must treat as a restoration $150,000 ($500,000 - $350,000) of the $400,000 paid for the portion of the costs related to repairing and cleaning the building structure. Thus, in addition of the $350,000 to replace the roof structure, C must also capitalize the $150,000 as an improvement to the building unit of property. C is not required to capitalize the remaining $250,000 repair and cleaning cost. [Reg. 1.263(a)-3(d)(7), Ex. 5]

3) State of Disrepair

a) Example. F owns and operates a farming and cattle ranch with an irrigation system that provides water for crops. Assume that each canal in the irrigation system is a single unit of property and has a class life of 20 years. At the time F placed the canals into service, F expected to have to perform major maintenance on the canals every three years to keep the canals in their ordinarily efficient operating condition. This maintenance includes draining the canals, and then cleaning, inspecting, repairing, and reconditioning or replacing parts of the canal with comparable and commercially available replacement parts. F placed the canals into service in Year 1 and did not perform any maintenance on the canals until Year 6. At that time, the canals had fallen into a state of disrepair and no longer functioned for irrigation. In Year 6, F pays amounts to drain the canals and do extensive cleaning, repairing, reconditioning, and replacing parts of the canals with comparable and commercially available replacement parts. Although the work performed on F's canals was similar to the activities that F expected to perform, but did not perform, every three years, the costs of these activities do not fall within the routine maintenance safe harbor. Specifically, routine maintenance does not include activities that return a unit of property to its former ordinarily efficient operating condition if the property has deteriorated to a state of disrepair and is no longer functional for its intended use. Accordingly, amounts that F pays for work performed on the canals in Year 6 must be capitalized if they result in improvements.

4) Not Replacement of Major Component

a) Example. O owns an office building that it uses to provide services to customers. The building contains a HVAC system that incorporates ten roof-mounted units that provide heating and air conditioning for the building. The HVAC system also consists of controls for the entire system and duct work that distributes the heated or cooled air to the various spaces in the building's interior. O begins to experience climate control problems in various offices throughout the office building and consults with a contractor to determine the cause. The contractor recommends that O replace three of the roof-mounted heating and cooling units. O pays an amount to replace the three specified units. No work is performed on the other roof-mounted heating and cooling units, the duct work, or the controls. An amount is paid to improve a building if the amount restores the building structure or any building system. The HVAC system, including the 10 roof-mounted heating and cooling units, is a building system. As the components that generate the heat and the air conditioning in the HVAC system, the 10 roof-mounted units, together, perform a discrete and critical function in the operation of the HVAC system and, therefore, are a major component of the HVAC system. The three roof-mounted heating and cooling units are not a significant portion of a major component of the HVAC system, or a substantial structural part of the HVAC system. Accordingly, O is not required to treat the amount paid to replace the three roof-mounted heating and cooling units as a restoration of the building.

d. Adaption

1) An expenditure results in an adaptation to a new or different use if it adapts the unit of property to a use inconsistent with the taxpayer's intended ordinary use at the time the taxpayer originally placed the property into service. [Sec. 1.263(a)-3(l)(1)]

2) Example. C owns a building consisting of twenty retail spaces. C decides to sell the building. In anticipation of selling the building, C pays an amount to repaint the interior walls and to refinish the hardwood floors. An amount is paid to improve C's building to a new or different use if it adapts the building structure or any of the building systems to a new or different use. Preparing the building for sale does not constitute a new or different use for the building structure. Therefore, the amount paid by C to prepare the building structure for sale does not improve the building is not required to be capitalized.

e. The judicially-created plan of rehabilitation doctrine provides that a taxpayer must capitalize otherwise deductible repair or maintenance cost if they are incurred as part of a general plan of rehabilitation, modernization, and improvement to the property.

f. Indirect costs, such as repair and maintenance costs, that do not directly benefit and that are not incurred by reason of an improvement are not required to be capitalized regardless of whether they are incurred at the same time as an improvement.

4. Routine Maintenance Safe Harbor

a. The costs of performing certain routine maintenance activities for property other than a building or the structural components of a building are not required to be capitalized as an improvement.

b. Under the routine maintenance safe harbor, an amount paid is deemed not to improve a unit of property if it was for the recurring activities that a taxpayer (or a lessor) expected to perform as a result of the taxpayer's (or the lessee's) use of the unit of property to keep the unit of property in its ordinarily efficient operating condition.

c. The activities are routine only if, at the time the unit of property was placed in service, the taxpayer reasonable expected to perform the activities more than once during the Alternative Depreciation System class life, regardless of whether the property was depreciated under the Alternative Depreciation System.

d. A taxpayer's reasonable expectation of whether it will perform qualifying maintenance activities more than once during the relevant period will be determined at the time the unit of property (or building structure or system, as applicable) is place in service.

    1) Factors to consider – Recurring nature of the activity, industry practice, manufacturer's recommendations, and taxpayer's experience with similar property.

e. The final regulations permit the routine maintenance safe harbor (RMSH) to be applied to buildings, with an important modification. [Reg. 1.263(a)-3(I)]

f. The RMSH generally looks to the frequency of expected repairs and maintenance activities with the unit of property's alternative depreciation system recovery period, but for building that testing period is limited to 10 years. [Reg. 1.263(a)-3(i)(1)(i)]

    1) The RMSH for buildings will apply to repairs and maintenance activities that the taxpayer expects to perform at least twice within 10 years.

g. The final regulations exclude network assets from the scope of the RASH.

    1) To date, the government has issued industry-specific guidance regarding network assets used in the telecommunications and electric utility industries.

5. Removal Costs

a. Removal costs are deductible if, for federal tax purposes, the taxpayer disposes of the depreciable asset being removed and takes its basis into account in realizing gain or loss. [Reg. 1.263(a)-3(g)(2)(i)]

b. However, if the taxpayer removes a component of a unit of property but the removal is not treated as a disposition for federal tax purposes, the taxpayer deducts or capitalizes the removal costs based on whether those costs directly benefit or are incurred by reason of a repair to the unit of property or an improvement to the unit of property. [Reg. 1.263(a)-3(g)(2)(i)]

c. Example. Y owns a building in which it conducts its retail business. The roof over Y's building is covered with shingles. Over time, the shingles begin to wear and Y begins to experience leaks into its retail premises. However, the building still functions in Y's business. To eliminate the problems, a contractor recommends that Y remove the original shingles and replace them with new shingles. Accordingly, Y pays the contractor to replace the old shingles with new but comparable shingles. The new shingles are comparable to original shingles but correct the leakage problems. Assume that Y disposes of the original shingles, and the disposal of these shingles is not a disposition. Assume that replacement of old shingles with new shingles to correct the leakage is not a betterment or a restoration of the building structure or systems and does not adapt the building structure or systems to a new or different use. Thus, the amounts paid by Y to replace the shingles are not improvements to the building unit of property. The amounts paid to remove the shingles are not required to be capitalized because they directly benefit and are incurred by reason of repair or maintenance to the building structure.

d. Example. Assume the same facts as the previous example except Y disposes of the original shingles, and Y elects to treat the disposal of these components as a partial disposition of the building, and deducts the adjusted basis of the components as a loss on the disposition. Amounts paid for replacement of the shingles constitute a restoration of the building structure because the amounts are paid for the replacement of a component of the structure and the taxpayer has properly deducted a loss for that component. Thus, Y is required to capitalize the amounts paid for the replacement of the shingles as an improvement to the building unit of property. However, the amounts paid by Y to remove the original shingles are not required to be capitalized as part of the costs of the improvement, regardless of their relation to the improvement.

6. Small Business Building Expense Safe Harbor

a. The regulations permit a qualifying small taxpayer to elect to not apply the improvement rules to an eligible business property if the total amount paid during the taxable year for repairs, maintenance, improvements, and similar activities performed on the eligible building does not exceed the lesser of $10,000 or 2 percent of the unadjusted basis of the building. [Reg. 1.263(a)-3(h)(1)]

b. A qualifying taxpayer is a taxpayer whose average annual gross receipts for the three preceding taxable years is less or equal to $10,000,000.

c. Eligible building property includes a building unit of property that is owed or leased by the qualifying taxpayer, provided the unadjusted basis of the building unit of property is $1,000,000 or less.

d. The cost of personal property identified in a cost segregation study should not be counted toward the unadjusted basis of a building under a strict construction of the regulations, since each item of such personal property is a separate unit of property and not part of the building unit of property (Reg. §1.263(a)-3(e)(5)(ii)). Consequently, an additional benefit of a cost segregation study is that could allow a building to qualify for the safe harbor.

e. The safe harbor does not apply to costs paid with respect to exterior land improvements that are separate units of property.

f. 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 taxpayer year in which the lease is entered indicated a reasonable expectancy of renewal. [Reg. 1.263(a)-3(h)(5)]

g. Example. A taxpayer enters into a 20-year lease of a building in which it operates a retail store. If the monthly rent is $4,000, the unadjusted basis of the building is $960,000 ($4,000 × 12 months × 20 years). The safe harbor may be elected if the taxpayer satisfies the gross receipts test [Reg. §1.263(a)- 3(h)(10), Ex. 4].

h. The regulations eliminate the need to separately analyze the building structure and the building systems, as required elsewhere in the improvement rules in the regulations.

i. The safe harbor for building property held by small taxpayers may be elected annually on a building-by-building basis by including a statement on the taxpayer's timely filed original Federal tax return, including extensions, for the year the costs are incurred for the building. [Reg. 1.263(a)-3(h)(6)]

j. Amounts paid by the taxpayer to which the taxpayer properly applies and elects the safe harbor are not treated as improvements to the building and may be deducted in the taxable year that the amounts are paid or incurred, provided the amounts otherwise qualify for a deduction.

k. The taxpayer may also elect to apply the de minimis safe harbor under Sec. 1.263(a)-1(f) ($5,000/$500) to amounts qualifying under the de minimis safe harbor for small taxpayers.

l. The statement titled, “Section 1.263(a)-3(h) Safe Harbor Election for Small Taxpayers” and include the taxpayer’s name address, taxpayer identification number, and a description of each eligible building property to which the taxpayer is applying the election must be attached to the return. [Reg. 1.263(a)-3(h)(6)]

m. The language should include: “The amounts paid for repairs, maintenance, improvement, and similar activities performed on the eligible building(s) under the safe harbor provided in Regulations Section 1.263(a)-3(h)(i).

E. Dispositions

1. A disposition occurs when ownership of the asset is transferred or when the asset is permanently withdrawn from use either in the taxpayer’s trade or business or in the production of income. A disposition includes the sale, exchange, retirement, physical abandonment, or destruction of an asset. A disposition also includes the retirement of a structural component (or a portion thereof) of a building only if the partial disposition rule applies to such structural component (or a portion thereof).

2. Under the general rule, the property being disposed of will be an entire building, for example, rather than individual building components. [Reg. 1.168(i)-8(c)(4)]

3. The disposition of the entire building will be treated under the normal rules governing complete dispositions.

4. When the taxpayer disposes of less than the entire building (voluntarily or involuntarily), however, the general rule would require the taxpayer to recognize gain or loss on that partial disposition in four situations: (1) a casualty event; (2) the deferral of gain under Section 1031 or 1033; (3) the transfer of assets in a Section167(i)(7)(b) “step in the shoes” transaction; or (4) a sale of a portion of the asset.

   a. For example, if the taxpayer sells a one-half interest in the building, the normal rules for determining gain or loss on that sale must be applied. Similarly, if the building’s roof is destroyed in a hurricane, the casualty loss rules apply.

5. For any other transaction, the regulations generally would ignore the partial disposition for tax purposes, and the taxpayer would continue depreciating the property as before.

6. 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.

7. The regulations would allow the taxpayer to elect to recognize the partial disposition for tax purposes, however, as long as the property is not held in a General Asset Account (GAA). [Reg. 1.168(i)-8(d)(2)]

    a. The election would allow the taxpayer to recover the remaining basis in whatever portion of the building that has been disposed of, and the costs of replacing that portion of the property would be capitalized under the restoration standards of Reg. 1.263(a)-3(k).

    b. The election is made on the taxpayer's original return for the year in which the partial disposition occurs, and once made can be revoked only with IRS consent (through the filing of a private letter ruling request, rather than a request to change accounting methods). [Reg. 1.168(i)-8(d)(2)(ii)(B)]

8. IRS Disallowance of Deduction

    a. 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, 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.

9. Determining Basis of Disposed Asset

    a. The taxpayer may use any reasonable method that is consistently applied to all assets in the same multiple asset account.

    b. Examples in the regulations include:

        1) Discounting the cost of the replacement asset to its placed-in-service year cost using the Producer Price Index for Finished Goods (or its successor, the Producer Price Index for Final Demand, or any other index designated by guidance in the Internal Revenue Bulletin) where the replacement asset is a restoration.

        2) A pro rate allocation of the unadjusted depreciable basis of the multiple asset account based on the replacement cost of the disposed asset and the replacement cost of all of the assets in the multiple asset account; and

        3) A study allocating the cost of the asset to its individual components.

10. Examples

    a. Example. Apex owns an office building with four elevators. A replaces one of the elevators. The elevator is a structural component of the office building. The office building, including its structural components, is the asset for disposition purposes. Apex does not make the partial disposition election for the elevator. Thus, the retirement of the replaced elevator is not a disposition. As a result, depreciation continues for the cost of the building, including the cost of the retired elevator and the building's other structural components, and Apex does not recognize a loss for this retired elevator. If Apex must capitalize the amount paid for the replacement elevator, the replacement elevator is a separate asset for disposition purposes and for depreciation purposes.

b. Example. The facts are the same as in the previous example, except Apex makes the partial disposition election for the elevator. Although the office building, including its structural components, is the asset for disposition purposes, the result of Apex making the partial disposition election for the elevator is that the retirement of the replaced elevator is a disposition. Thus, depreciation for the retired elevator ceases at the time of its retirement, taking into account the applicable convention, and Apex recognizes a loss upon this retirement. Further, Apex must capitalize the amount paid for the replacement elevator, and the replacement elevator is a separate asset for disposition purposes and for depreciation purposes.

c. Example. Dame owns a retail building. Dame replaces 60% of the roof of this building. The retail building, including its structural components, is the asset for disposition purposes. Assume Dame must capitalize the costs incurred for replacing 60% of the roof. Dame makes the partial disposition election for the 60% of the replaced roof. Thus, the retirement of 60% of the roof is a disposition. As a result, depreciation for 60% of the roof ceases at the time of its retirement, taking into account the applicable convention, and Dame recognizes a loss upon this retirement. Further, Dame must capitalize the amount paid for the 60% of the roof and the replacement 60% of the roof is a separate asset for disposition purposes and for depreciation purposes.

d. Example. The facts are the same as in previous example. Ten years after replacing 60% of the roof, Dame replaces 55% of the roof of the building. The replacement 60% of the roof, is an asset and the replacement 60% of the roof is a separate asset. Assume Dame must capitalize the costs incurred for replacing 55% of the roof. Dame makes the partial disposition election for the 55% of the replaced roof. Thus, the retirement of 55% of the roof is a disposition. However, Dame cannot determine from its records whether the replaced 55% is part of the 60% of the roof replaced ten years ago or whether the replaced 55% includes part or all of the remaining 40% of the original roof. Dame identifies which asset it disposed of by using the first-in, first-out method of accounting. As a result, Dame disposed of the remaining 40% of the original roof and 25% of the 60% (15%) of the roof replaced ten years ago. Thus, depreciation for the remaining 40% of the original roof ceases at the time of its retirement, taking into account the applicable convention, and Dame recognizes a loss upon this retirement. Further, depreciation for 25% of the 60% of the roof replaced ten years ago ceases at the time of its retirement, taking into account the applicable convention, and Dame recognizes a loss upon this retirement. Also, Dame must capitalize the amount paid for the 55% of the roof, and the replacement 55% of the roof is a separate asset for disposition purposes and for depreciation purposes.

11. General Asset Accounts

a. The MACRS disposition regulations eliminate the requirement that the recognition of loss on the retirement of a structural component is elective only if the building was placed in a general asset account.

    1) Taxpayers that had made the GAA election under the temporary regulations may want to make a change of accounting method that allows for revocation of those GAA elections. – Change 197

b. The regulations restore the use of GAAs to what the government believes to be their originally intended function – allowing taxpayers to place into one or more GAAs many items of property that the taxpayer prefers not to track separately. Once placed into a GAA, the property‘s basis generally is recovered over its prescribed depreciable life, and dispositions are disregarded except in the limited circumstances applicable before the temporary regulations.

c. General Asset Account Dispositions

1) No loss is realized upon the disposition of an asset or a portion thereof.

a) The asset, or portion thereof, is treated as having a basis of zero.

2) Any amount realized on a disposition is recognized as ordinary income.

3) The taxpayer continues to depreciate the general asset account, including the disposed asset (or portion thereof), as though no disposition occurred.

F. Form 3115

1. The final regulations assign a number to the accounting method change being granted automatic approval.

2. No fee charged for the automatic consent. Normally $7,000.

3. Rev. Proc. 2014-16 states that a taxpayer should file a single Form 3115 reflecting all accounting method changes.

a. The detailed description of the taxpayer's present and proposed accounting method required by line 12 of Form 3115 should include a citation to the specific portion of the tangible proerty regulations that describes the method to which the taxpayer is changing.

4. Form 3115 for Small Taxpayers

a. A qualifying taxpayer is required to complete only the following information on Form 3115

1) The identification section of page (above Part I);

2) The signature section at the bottom of page 1;

3) Part I, line 1(a);

4) Part II, all lines except lines 11, 13, 14, 15, and 17;

5) Part II, line 13, if the change is to depreciating property;

6) Part IV, line 25 and 26; and

7) Schedule E, if applicable.

b. The reduced filing requirements only exempt filers from completing certain lines of Form 3115 and do not affect the detailed computations of any required Sec. 481(a) adjustment.

c. The term qualifying taxpayer means a taxpayer whose average annual gross receipts for the three preceding taxable years is less than or equal to $10,000,000.

5. Manner of Making Change

a. In addition to the other information required on line 12 of Form 3115, the taxpayer must include the following:

1) The citation to the paragraph of the final tangible property regulations or temporary tangible property regulations that provides for the proposed method, or method, of accounting to which the taxpayer is changing (e.g. Sec. 1.162-3(a), Sec. 1.263(a)-3(l), Sec. 263(a)-3(k)); and

2) If the taxpayer is changing any unit(s) of property under Sec. 1.263(a)-3(e) (or Sec. 1.263(a)-3T(e)) or, in the case of a building, is changing the identification of any building structure(s) or building system(s) under Sec. 1.263-3(e)(2) (or Sec. 1.263-3T(e)(2)) for purposes of determining whether amounts are deducted as repair and maintenance costs under Sections 1.162-4 (or Sec. 1.162-4T), the taxpayer must include a detailed description of the unit(s) of property, building structure(s), or buildings system(s) used under its present method of accounting and a detailed description of the unit(s) of property, building structure(s), and building system(s) under its proposed method of accounting, together with a citation to the paragraph of the final regulation or temporary regulation under which the unit of property is permitted.

b. A taxpayer changing its method of accounting to capitalizing amounts paid or incurred and to depreciating such property under Section 167 or Section 168, as applicable, must complete Schedule E of Form 3115.

6. Concurrent Automatic Change

a. A taxpayer that wants to make one or more changes in method of accounting relating to the same identified unit of property or, in the case of a building, the same identified building structure or building system should file such change on the same Form 3115 and provide a single section 481(a) adjustment for all the changes related to the identified property.

1) If one or more changes related to the identified property generate a negative Section 481(a) adjustment and other changes related to the same identified property generate a positive Section 481(a) adjustment, the taxpayer may provide a single negative Section 481(a) adjustment for all the changes related to the identified property generating such negative adjustment and a single positive adjustment for all the changes related to the identified property generating such positive adjustment.

G. Modified Section 481(A) Adjustment

1. Final Tangible Property Regulations

a. A taxpayer changing to a method of accounting under Sec. 1.162-3 (except Sec. 1.162-3(e)), Sec. 1.263(a)2(f)(2)(iii), Sec. 1.263(a)-2(f)(3)(ii), Sec. 1.263(a)–3(m), Sec. 1.263A-1(e)(2)(i)(A), and Sec. 1.263A-1(e)(3)(ii)(E) is required to calculate a Section 481(a) adjustment as of the first day of the taxpayer's taxable year of change that takes into account only amounts paid or incurred in taxable years beginning on or after January 1, 2014 ("modified Section 481(a) adjustment").

2. Temporary Tangible Property Regulations

a. A taxpayer changing to a method of accounting under Sec. 1.162-3T (except Sec. 1.162-1T(e))), Sec. 1.263(a)-2T(f)(2)(iii), Sec. 1.263(a)-2T(f)(3)(ii), Sec. 1.263(a)-2T(g), Sec. 1.263(a)-3T(k), Sec. 1.263A-1T(e)(2)(i)(A), and Sec. 1.263A-1T(e)(3)(ii)(E) is required to calculate a Section 481(a) adjustment as of the first day of the taxpayer's taxable year of change that takes into account only amounts paid or incurred in taxable years beginning on or after January 1, 2012, for a year of change beginning on or after January 1, 2012, and ending before January 1, 2014.

3. Itemized Listing on Form 3115

a. A taxpayer changing to a method of accounting must include on Form 3115, Part IV, line 25, the total Section 481(a) adjustment for each change in method of accounting being made.

b. If the taxpayer is making more than one change in method of accounting under the final tangible property regulations, the taxpayer must include on an attachment to Form 3115:

1) The information required by Part IV, line 25 for each change in method of accounting (including the amount of the Section 481(a) adjustment for each change in method of accounting, which includes the portion of the Section 481(a) adjustment attributable to UNICAP).

2) The information required by Part II, line 12 of Form 3115 that is associated with each change; and

3) The citation to the paragraph of the final tangible property regulations or temporary tangible property regulations that provides for each proposed method of accounting.

4. Repair Allowance Property

a. A taxpayer changing to a method of accounting provided by Sec. 1.263(a)-3 of the final tangible property regulations or Sec. 1.263(a)-3T of the temporary tangible property regulations must not include in the Section 481(a) adjustment any amount attributable to property for which the taxpayer elected to apply the repair allowance under Sec. 1.167(a)-11(d)(2) for any taxable year in which the repair allowance election was made.

H. Ogden Copy of Form 3115 Required in Lieu of National Office Copy

1. A taxpayer changing its method of accounting must file a signed copy of its completed Form 3115 with the IRS in Ogden, UT, in lieu of filing the national office copy, no earlier than the first day of the year of change and no later than the date the taxpayer files the original Form 3115 with its federal income tax return for the year of change.

I. Circular 230 Implications

1. Circular 230 governs practice before the IRS (including by CPAs and other enrolled tax return preparers), which includes preparing documents, filing documents, and communicating with the IRS. Under Section 10.34 of Circular 230 a practitioner may not willfully, recklessly, or through gross incompetence sign a tax return or claim for refund that the practitioner knows or reasonably should know contains a position that lacks a reasonable basis. Failure to comply with Circular 230 could result in censure, suspension, or disbarment of any practitioner from practice before the IRS.

2. There is also no materiality threshold for Circular 230, which means that if a CPA files a federal tax return for 2014 for a client without a Form 3115 or certain election statements, the CPA could be in violation of Circular 230 and subject to disciplinary action. With the threat of possible sanctions, the complexity of the regulations, possible new recordkeeping requirements, and the need for certain election statements, CPAs need to have timely discussions with their clients to address the impact of the final regulations in filing clients' 2014 tax returns.

J. Designated Automatic Accounting Method Change Number

(a) Changes under the final tangible property regulations.

Description of Change	DCN	Citation
A change to deducting amounts paid or incurred for repair and maintenance or a change to capitalizing amounts paid or incurred for improvements to tangible property and, if depreciable, to depreciating such property under section 167 or section 168. Includes a change, if any, in the method of identifying the unit of property, or in the case of a building, identifying the building structure or building systems for the purpose of making this change.	184	§§ 1.162-4, 1.263(a)-3
Change to the regulatory accounting method.	185	§ 1.263(a)-3(m)
Change to deducting non-incidental materials and supplies when used or consumed.	186	§§ 1.162-3(a)(1), (c)(1)
Change to deducting incidental materials and supplies when paid or incurred.	187	§§ 1.162-3(a)(2), (c)(1)
Change to deducting non-incidental rotable and temporary spare parts when disposed of.	188	§ 1.162-3(a)(3), (c)(2)
Change to the optional method for rotable and temporary spare parts.	189	§ 1.162-3(e)
Change by a dealer in property to deduct commissions and other transaction costs that facilitate the sale of property.	190	§ 1.263(a)-1(e)(2)
Change by a non-dealer in property to capitalizing commissions and other costs that facilitate the sale of property.	191	§ 1.263(a)-1(e)(1)
Change to capitalizing acquisition or production costs and, if depreciable, to depreciating such property under section 167 or section 168.	192	§ 1.263(a)-2
Change to deducting certain costs for investigating or pursuing the acquisition of real property (whether and which).	193	§ 1.263(a)-2(f)(2)(iii)

(b) Changes under the temporary tangible property regulations.

Description of Change	DCN	Citation
A change to deducting amounts paid or incurred for repair and maintenance or a change to capitalizing amounts paid or incurred for improvements to tangible property and, if depreciable, to depreciating such property under section 167 or section 168. Includes a change, if any, in the method of identifying the unit of property, or in the case of a building, identifying the building structure or building systems for the purpose of making this change.	162	§§ 1.162-4T, 1.263(a)-3T
Change to the regulatory accounting method.	163	§ 1.263(a)-3T(k)(2)
Change to deducting non-incidental materials and supplies when used or consumed.	164	§§ 1.162-3T(a)(1), (c)(1)
Change to deducting incidental materials and supplies when paid or incurred.	165	§§ 1.162-3T(a)(2), (c)(1)
Change to deducting non-incidental rotable and temporary spare parts when disposed of.	166	§ 1.162-3T(a)(3), (c)(2)
Change to the optional method for rotable and temporary spare parts.	167	§ 1.162-3T(e)
Change by a dealer in property to deduct commissions and other costs that facilitate sales.	168	§ 1.263(a)-1T(d)(1)
Change to applying the de minimis rule	169	§§ 1.263(a)-2T(g), 1.263A-1T(b)(14)
Change to deducting certain costs for investigating or pursuing the acquisition of real property.	170	§ 1.263(a)-2T(f)(2)(iii)
Change by non-dealer in property to capitalizing commissions and other costs that facilitate sales.	172	§ 1.263(a)-1T(d)(1)
Change to capitalizing acquisition or production costs and, if depreciable, to depreciating such property under section 167 or section 168.	173	§1.263(a)-2T

FINAL REGULATION SECTION	SECTION # in APPENDIX in REV REV. PROC. 2011-14	DESIGNATED CHANGE NUMBER (DCN)	FOR MORE INFORMATION SEE
§ 1.167(a)-4, Depreciation of leasehold improvements	6.36	199	Section 3.03(4) of Rev. Proc. 2014-17
General Asset Accounts:			
a. § 1.168(i)-1(c), Change in grouping assets	6.37	200	Section 3.02(7) of Rev. Proc. 2014-54
b. § 1.168(i)-1(e)(2)(viii), Change in determining asset disposed of	6.40	207	Section 3.03(3) of Rev. Proc. 2014-54
c. § 1.168(i)-1(j)(2), Change in method of identifying which assets or portions of assets have been disposed of from one method to another method specified in § 1.168(I)-1(j)(2)	6.37	200	Section 3.02(7) of Rev. Proc. 2014-54
d. § 1.168(i)-1(j)(2), Change in method of identifying which assets or portions of assets have been disposed of from a method not specified in § 1.168(i)-1(j)(2) to a method specified in § 1.168(i)-1(j)(2)	6.40	207	Section 3.03(3) of Rev. Proc. 2014-54
e. § 1.168(i)-1(j)(3), Change in determining unadjusted depreciable basis of disposed asset or disposed portion of an asset from one reasonable method to another reasonable method when it is impracticable from the taxpayer's records to determine the unadjusted depreciable basis of disposed asset or disposed portion of asset	6.37	200	Section 3.02(7) of Rev. Proc. 2014-54

f. § 1.168(i)-1(j)(3), Change in determining unadjusted depreciable basis of disposed asset or disposed portion of an asset from not using to using the taxpayer's records when it is practicable from the taxpayer's records to determine the unadjusted depreciable basis of disposed asset or disposed portion of asset	6.40	207	Section 3.03(3) of Rev. Proc. 2014-54
g. § 1.168(i)-1(j)(3), Change in determining unadjusted depreciable basis of disposed asset or disposed portion of an asset from an unreasonable method to a reasonable method when it is impracticable from the taxpayer's records to determine the unadjusted depreciable basis of disposed asset or disposed portion of asset	6.40	207	Section 3.03(3) of Rev. Proc. 2014-54
Single Asset Accounts or Multiple Asset Accounts for MACRS Property:			
a. § 1.168(i)-7, Change from single asset accounts to multiple asset accounts, or vice versa	6.37	200	Section 3.03(5) of Rev. Proc. 2014-17, as modified by section 3.02(7) of Rev. Proc. 2014-54
b. § 1.168(i)-7(c), Change in grouping assets in multiple asset accounts	6.37	200	Section 3.03(5) of Rev. Proc. 2014-17, as modified by section 3.02(7) of Rev. Proc. 2014-54

Dispositions of MACRS Property (not in a general asset account):

a. § 1.168(i)-8(c)(4), Change in determining asset disposed of	6.38 (Building or structural component)	205	Section 3.03(1) of Rev. Proc. 2014-54
	6.39 (Property other than a building or structural component)	206	Section 3.03(2) of Rev. Proc. 2014-54
b. § 1.168(i)-8(f)(2) or (3), Change in determining unadjusted depreciable basis of disposed asset in a multiple asset account or disposed portion of an asset from one reasonable method to another reasonable method when it is impracticable from the taxpayer's records to determine the unadjusted depreciable basis of disposed asset or disposed portion of asset	6.37	200	Section 3.02(7) of Rev. Proc. 2014-54
c. § 1.168(i)-8(f)(2) or (3), Change in determining unadjusted depreciable basis of disposed asset in a multiple asset account or disposed portion of an asset from not using to using the taxpayer's records when it is practicable from the taxpayer's records to determine the unadjusted depreciable basis of disposed asset or disposed portion of asset	6.38 (Building or structural component)	205	Section 3.03(1) of Rev. Proc. 2014-54
	6.39 (Property other than a building or structural component)	206	Section 3.03(2) of Rev. Proc. 2014-54
d. § 1.168(I) -8(f)(2) or (3), Change in determining unadjusted depreciable basis of disposed asset in a multiple asset account or disposed portion of an asset from an unreasonable method to a reasonable method when it is impracticable from the taxpayer's records to determine the unadjusted depreciable basis of disposed asset or disposed portion of asset	6.38 (Building or structural component)	205	Section 3.03(1) of Rev. Proc. 2014-54
	6.39 (Property building or structural component)	206	Section 3.03(2) of Rev. Proc. 2014-54

e. § 1.168(i)-8(g), Change in method of identifying which assets in a multiple asset account or portions of assets have been disposed of from one method to another method specified in § 1.168(I)-8(g)(1) or (2)	6.37	200	Section 3.02(7) of Rev. Proc. 2014-54
f. § 1.168(i)-8(g), Change in method of identifying which assets in a multiple asset account or portions of assets have been disposed of from a method not specified in § 1.168(I)-8(g)(1) or (2) to a method specified in § 1.168(I)-8(g)(1) or (2)	6.38 (Building or structural component)	205	Section 3.03(1) of Rev. Proc. 2014-54
	6.39 (Property other than a building or structural component)	206	Section 3.03(2) of Rev. Proc. 2014-54
g. § 1.168(i)-8(h)(1), Change from depreciating a disposed asset or disposed portion of an asset to recognizing gain or loss upon disposition when a taxpayer continues to depreciate the asset or portion that the taxpayer disposed of prior to the year of change	6.38 (Building or structural component)	205	Section 3.03(1) of Rev. Proc. 2014-54
	6.39 (Property other than a building or structural component)	206	Section 3.03(2) of Rev. Proc. 2014-54
h. § 1.168(i)-8(d)(2)(iii), Partial disposition election for the disposition of a portion of an asset to which the IRS's adjustment pertains	6.35	198	Section 3.02(6) of Rev. Proc. 2014-54

Late elections or revocation of a general asset account election. The following chart summarizes the late elections under § 1.168(i)-1, § 1.168(i)-8, Prop. Reg. § 1.168(i)-1, Prop. Reg. § 1.168(i)-8, or § 1.168(1)-1T that are treated as a change in method of accounting for a limited period of time. The chart includes the revocation of a general asset account election that also is treated as a change in method of accounting for a limited period of time.

ELECTION OR REVOCATION	TIME PERIOD FOR TREATING ELECTION OR REVOCATION OR METHOD CHANGE	SECTION # IN APPENDIX IN REV. PROC. 2011, AND DCN	FOR MORE INFORMATION SEE
General Asset Accounts:			
a. Late general asset account election under § 1.168(i)-1, Prop. Reg. § 1.168(i)-1, or § 1.168(1)-1T	Taxable year beginning on or after 1/1/2012 and beginning before 1/1/2014	6.32 DCN 180	Section 3.02(9) of Rev. Proc. 2014-17, as modified by section 3.02(3) of Rev. Proc. 2014-54
b. Late election to recognize gain or loss upon disposition of all assets, the last asset, or the remaining portion of the last asset under § 1.168(i)-1(e)(3)(ii) or Prop. Reg. § 1.168(I)-1(e)(3)(ii)	Taxable year beginning on or after 1/1/2012 and beginning before 1/1/2014	6.32 DCN 180	Section 3.02(9) of Rev. Proc. 2014-17, as modified by section 3.02(3) of Rev. Proc. 2014-54
c. Late election to recognize gain or loss upon disposition of all assets or the last asset under § 1.168(1)-1T(e)(3)(ii)	Taxable year beginning on or after 1/1/2012 and beginning before 1/1/2014	6.32 DCN 180	Section 3.02(9) of Rev. Proc. 2014-17, as modified by section 3.02(3) of Rev. Proc 2014-54
d. Late election to recognize gain or loss upon disposition of an asset in a qualifying disposition under § 1.168(i)-1(e)(3)(iii), Prop. Reg. § 1.168(i)-1(e)(3)(iii), or § 1.168(1)-1T(e)(3)(iii)	Taxable year beginning on or after 1/1/2012 and beginning before 1/1/2014	6.32 DCN 180	Section 3.02(9) of Rev. Proc. 2014-17, as modified by section 3.02(3) of Rev. Proc. 2014-54

e. Revocation of a general asset account election made under § 1.168(i)-1, Prop. Reg. § 1.168(i)-1, or § 1.168(1)-1T, or made under section 6.32 in Appendix in Rev. Proc. 2011-14	Taxable year beginning on or after 1/1/2012 and beginning before 1/1/2015	6.34 DCN 197	Section 3.03(2) of Rev. Proc. 2014-17, as modified by section 3.02(5) of Rev. Proc. 2014-54

Late Partial Disposition Election for MACRS Property (not in a general asset account):

a. Late partial disposition election made under § 1.168(i)-8(d)(2)(iv)(B)	First or second taxable succeeding the applicable taxable year as defined in § 1.168(i)-8(d)(2)(iv)	6.33 DCN 196	Section 3.02(4) of Rev. Proc. 2014-54
b. Other late partial disposition elections made under § 1.168(i)-8(d)(2)(i)	Taxable year beginning on or after 1/1/2012 and beginning before 1/1/2015	6.33 DCN 196	Section 3.02(4) of Rev. Proc. 2014-54
c. Late partial disposition election made under Prop. Reg. § 1.168(I)-8(d)(2)(iv)(B)	First or second taxable succeeding the applicable taxable year as defined in Prop. Reg. § 1.168(I)-8(d)(2)(iv)	6.33 DCN 196	Section 3.03(1) of Rev. Proc. 2014-17, as modified by section 3.02(4) of Rev. Proc 2014-54
d. Other late partial disposition elections made under Prop. Reg. § 1.168(I)-8(d)(2)(i)	Taxable year beginning on or after 1/1/2012 and beginning before 1/1/2014	6.33 DCN 196	Section 3.03(1) of Rev. Proc 2014-17, as modified by section 3.02(4) of Rev. Proc. 2014-54

Temporary and proposed regulations. If a taxpayer applies § 1.167(a)-4T, § 1.168(i)-1T, § 1.168(i)-7T, § 1.168(i)-8T, Prop. Reg. § 1.168(i)-1, Prop. Reg. § 1.168(i)-7, or Prop. Reg. § 1.168(i)-8 for a taxable year beginning on or after January 1, 2012, and beginning before January 1, 2014, the following chart summarizes the changes in methods of accounting under those regulation sections that the taxpayer may make under Rev. Proc. 2011-14.

TEMPORARY OR PROPOSED REGULATION SECTION	SECTION # in APPENDIX in REV. PROC. 2011-14	DCN	FOR MORE INFORMATION SEE
§ 1.167(a)-4T, Depreciation of leasehold improvements	6.27	175	Section 3.02(4) of Rev. Proc. 2014-17
General Asset Accounts:			
a. § 1.168(i)-1T(c) or Prop. Reg. § 1.168(i)-1(c), Change in grouping assets	6.28	176	Section 3.02(5) of Rev. Proc. 2014-17
b. § 1.168(i)-1T(e)(2)(viii) or Prop. Reg. § 1.168(i)-1(e)(2)(viii), Change in determining asset disposed of	6.31	179	Section 3.02(8) of Rev. Proc. 2014-17
c. § 1.168(i)-1T(j)(2) or Prop. Reg. § 1.168(i)-1(j)(2), Change in method of identifying which assets have been disposed of from one method to another method specified in § 1.168(i)-1T(j)(2), or from one method to another method specified in Prop. Reg. § 1.168(i)-1(j)(2)	6.28	176	Section 3.02(5) of Rev. Proc. 2014-17
d. § 1.168(i)-1T(j)(2) or Prop. Reg. § 1.168(i)-1(j)(2), Change in method of identifying which assets have been disposed of from a method not specified in § 1.168(i)-1T(j)(2) to a method specified in § 1.168(i)-1T(j)(2), or from a method not specified in Prop. Reg. § 1.168(i)-1(j)(2) to a method specified in Prop. Reg. § 1.168(i)-1(j)(2)	6.31	179	Section 3.02(8) of Rev. Proc. 2014-17
e. § 1.168(i)-1T(j)(3), Change in determining unadjusted depreciable basis of disposed asset from one reasonable method to another reasonable method	6.28	176	Section 3.02(5) of Rev. Proc. 2014-17
f. Prop. Reg. § 1.168(i)-1(j)(3), Change in determining unadjusted depreciable basis of disposed asset or disposed portion of an asset from one reasonable method to another reasonable method	6.28	176	Section 3.02(5) of Rev. Proc. 2014-17

Single Asset Accounts or Multiple Asset Accounts for MACRS Property:			
a. § 1.168(i)-7T or Prop. Reg. § 1.168(i)-7, Change from single asset accounts to multiple asset accounts, or vice versa	6.28	176	Section 3.02(5) of Rev. Proc. 2014-17
b. § 1.168(i)-7T(c), Change in grouping assets in multiple asset accounts	6.28	176	Section 3.02(5) of Rev. Proc. 2014-17
Dispositions of MACRS Property (not in a general asset account):			
a. § 1.168(i)-8T(c)(4) or Prop. Reg. § 1.168(i)-8(c)(4), Change in determining asset disposed of	6.29 (Building or structural component)	177	Section 3.02(6) of Rev. Proc. 2014-17, as modified by section 3.02(2) of Rev. Proc. 2014-54
	6.30 (Property other than a building or structural component)	178	Section 3.02(7) of Rev. Proc. 2014-17
b. § 1.168(i)-8T(e)(2) or Prop. Reg. § 1.168(i)-8(f)(2), Change in determining unadjusted depreciable basis of disposed asset in a multiple asset account from one reasonable method to another reasonable method when it is impracticable from the taxpayer's records to determine the unadjusted depreciable basis of disposed asset	6.28	176	Section 3.02(5) of Rev. Proc. 2014-17
c. Prop. Reg. § 1.168(i)-8(f)(3), Change in determining unadjusted depreciable basis of disposed portion of an asset from one reasonable method to another reasonable method	6.28	176	Section 3.02(5) of Rev. Proc. 2014-17
d. § 1.168(i)-8T(f) or Prop. Reg. § 1.168(i)-8(g), Change in method of identifying which assets in a multiple asset account have been disposed of from one method to another method specified in § 1.168(i)-8T(f)(1) or (2), or from one method to another method specified in Prop. Reg. § 1.168(i)-8(g)(1) or (2)	6.28	176	Section 3.02(5) of Rev. Proc. 2014-17

e. § 1.168(i)-8T(f) or Prop. Reg. § 1.168(i)-8(g), Change in method of identifying which assets in a multiple asset account have been disposed of from a method not specified in § 1.168(i)-8T(f)(1) or (2) to a method specified in § 1.168(i)-8T(f)(1) or (2), or from a method not specified in Prop. Reg. § 1.168(i)-8(g)(1) or (2) to a method specified in Prop. Reg. § 1.168(i)-8(g)(1) or (2)	6.29 (Building or structural component) 6.30 (Property other than a building or structural component)	177 178	Section 3.02(6) of Rev. Proc. 2014-17, as modified by section 3.02(2) of Rev. Proc. 2014-54 Section 3.02(7) of Rev. Proc. 2014-17
f. § 1.168(i)-8T(g)(1) or Prop. Reg. § 1.168(i)-8(h)(1), Change from depreciating a disposed asset or disposed portion of an asset to recognizing gain or loss upon disposition when a taxpayer continues to depreciate the asset or portion that the taxpayer disposed of prior to the year of change	6.29 (Building or structural component) 6.30 (Property other than a building or structural component)	177 178	Section 3.02(6) of Rev. Proc. 2014-17, as modified by section 3.02(2) of Rev. Proc. 2014-54 Section 3.02(7) of Rev. Proc. 2014-17
g. Prop. Reg. § 1.168(i)-8(d)(2)(iii), Partial disposition election for the disposition of a portion of an asset to which the IRS's adjustment pertains	6.35	198	Section 3.03(3) of Rev. Proc. 2014-17, as modified by section 3.02(6) of Rev. Proc. 2014-54

K. Form 3115: Required Change of Accounting Method - Required For:

1. Materials and Supplies

a. Change to deducting the cost of incidental materials and supplies to the year paid or incurred – change 187; cut-off method; cite Regs. 1.162-3(a)(2), (c)(1)

b. Change to deducting the cost of non-incidental materials and supplies to the year used or consumed – change 186; cut-off method; cite Regs. 1.162-3(a)(1), (c)(1)

c. Change to deducting the cost of non-incidental rotable and temporary spare parts to the year disposed of – change 188; cut-off method; cite Regs. 1.162-3(a)(3), (c)(2)

d. Change to the optional method for rotable and temporary spare parts – change 189; Sec. 481(a) adjustment; cite Reg. 1.162-3(e)

e. Changes 186, 187, and 188 are "paid or incurred" methods that require the calculation of a modified Code Sec. 481(a) adjustment. Therefore, if the change is made in the 2014 tax year, no adjustment is required. The optional accounting method for rotable and temporary spare parts requires the computation of a full Sec. 481(a) adjustment.

2. Unit of Property

    a. A taxpayer using a unit-of-property definition that differs from the definition in the final regulations is using an improper accounting method and is required to file Form 3115. A change to deducting amounts paid or incurred for repair and maintenance or a change to capitalizing amounts paid or incurred for improvements to tangible property and, if depreciable, to depreciating such property under section 167 or section 168. Includes a change, if any, in the method of identifying the unit of property, or in the case of a building, identifying the building structure or building systems for the purpose of making this change. – change 184; Sec. 481(a) adjustment; cite Regs. 1.162-4, 1.263(a)-3

3. Amounts Paid to Improve Tangible Property

    a. Taxpayers who previously deducted expenses that should have been capitalized under the rules for betterments, restorations, and adaptions are required to change their accounting method and compute a position (unfavorable Sec. 481(a) adjustment equal to the difference between the deducted amount and the amount of any depreciation that could have been claimed on the deducted amount if it had been capitalized prior to the year of change.

    b. Changes include a change to capitalize and, if applicable, a change to depreciate the capitalized amount. A change in the definition of a unit of property may also be required.

        1) Change 184 applies to these three (capitalize, depreciate, and definition) changes in accounting method.

    c. Change 184 also applies where a taxpayer capitalized amounts that should have been deducted under the standards of the final regulations. In this situation, the taxpayer computes a negative (favorable) Sec. 481(a) adjustment equal to the difference between the capitalized amount and any depreciation claimed on the capitalized amount prior to the year of change.

    d. Cite Secs. 1.162-4, 1.263(a)-3

4. Routine Maintenance Safe Harbor

    a. The routine maintenance safe harbor is considered an accounting method and requires a full Sec. 481(a) adjustment (i.e., it is not a “paid or incurred” method applied on a cut-off basis). To change to the safe harbor method provided in the final regulations , a taxpayer files Form 3115. – change 184; Sec. 481(a) adjustment; cite Reg. 1.263(a)(3(i).

        1) Rev. Proc. 2012-19 used change 171 and Rev. Proc. 2014-16 consolidates this change with other changes to change 184.

5. Election to Capitalize in Accordance with Books

    a. The election to capitalize in accordance with books is not an accounting method. However, a taxpayer that does not make this election is adopting an improper accounting method when it improperly capitalizes a repair expense. A change is required from an improper capitalization of a repair expense and from an improper deduction to a capital expenditure. -- change 184; Sec. 481(a) adjustment; cite Reg. 1.263(a)-3(j), (k), or (l).

6. Transactions Costs Paid to Acquire or Produce Tangible Property

    a. Accounting method changes to comply with these rules are covered by change 192 and 193. – cite Reg. 1.263(a)-2

7. Buildings

    a. Taxpayers who claimed repair deductions by applying the unit-of-property rules in the prior proposed regulation will need to file a change of accounting method to capitalize the amounts previously deducted if they are required to be capitalized under the unit-of-property standards in the final regulations. These taxpayer must also file a concurrent accounting method change under Rev. Proc. 2014-16 to redefine the unit of property (Change 184). Cite 1.263(e)-3(e). Form 3115 must include a detailed description of the unit of property under the present system and under the proposed change.

    b. If a disposal of a component of an asset is not a disposition for federal income tax purposes, a change of accounting to comply with the final regulations is made under the automatic consent procedures of Appendix Sec. 10.11 of Rev. Proc. 20011-14 as added by Rev. Proc. 2014-16 (Change 184).

8. Betterments

    a. Taxpayers who previously deducted expenses that should have been capitalized under the rules for betterments, restorations, and adaptations are required to change their accounting method and compute a positive (unfavorable) Code Sec. 481(a) adjustment equal to the difference between the deducted amount and the amount of any depreciation that could have been claimed on the capitalized amount prior to the year of change. Changes include a change to capitalize and, if applicable, a change to depreciate the capitalized amount. A change in the definition of a unit of property may also be required. Change 184 of Rev. Proc. 2014-16 applies to these three changes in accounting method under the final regulations.

    b. Change 184 also applies where a taxpayer capitalized amounts that should have been deducted under the standards of the final regulations. In this situation, the taxpayer computes a negative (favorable) Code Sec. 481(a) adjustment equal to the difference between the capitalized amount and any depreciation claimed on the capitalized amount prior to the year of change. – cite Regs. 1.162-4, 1.263(a)-3

9. A change to capitalizing amounts paid or incurred to acquire or produce property in accordance with Reg. §1.263(a)- 2, and if depreciable, to depreciating such property under Code Secs. 167 or 168 (change 192); cite Reg. 1.263(a)-2

10. A change to deducting amounts paid or incurred in the process of investigating or otherwise pursuing the acquisition of real property. – Change 193; cut-off method; cite Reg. §1.263(a)-2(f)(2)(iii))

11. A change from capitalizing to deducting employee compensation and overhead costs incurred to investigate acquisition of real property. – Change 193; cut-off method; cite Reg. §1.263(a)-2(f)(2)(iv)

12. Use of General Asset Accounts

    a. Under the regulations, a taxpayer may not elect to recognize loss on the retirement of a structural component of a building in a GAA. Consequently, taxpayers should generally not place buildings in a GAA. Furthermore, taxpayers who made retroactive GAA elections or timely GAA elections for assets placed in service in a tax year beginning in 2012 or 2013 will likely want to revoke those elections by filing an accounting method change provided in Rev. Proc. 2014-17.

L. Elections Made Each Year

1. Election to Capitalize Repair and Maintenance in Accordance with Books

    a. A taxpayer that does not make this election is adopting an improper accounting method when it improperly capitalizes a repair expense. To change from an improper capitalization of a repair expense and from an improper deduction of a capital expenditure, taxpayers use change 184.

    b. The election is made by attaching a statement to a timely filed return (including extension) each year.

2. Safe Harbor for Small Taxpayers with Buildings

    a. The election is made annually by attaching a statement to a timely filed (including extension) original income tax return.

3. Change of Accounting Method – MACRS General Asset Accounts

    a. The final MACRS regulations contain a special rule that applies to assets placed in service in tax years ending before December 30, 2003. A taxpayer may treat a change to comply with the final MACRS regulations for such assets as a change that is not a change in accounting method. [Reg. 1.168(i)-8(j)(5); Reg. 1.168(i)-1(m)(5)]

    b. This means that no Form 3115 is filed and Sec. 481(a) adjustment (or a similar cumulative depreciation adjustment) is required or permitted. A taxpayer who follows the treatment must file amended federal tax returns for any open tax year, starting with the placed-in-service tax year. The amended return option will usually provide better results if a positive (unfavorable) adjustment would result from filing a Form 3115. [Rev. Proc. 2014-54, Section 3.01]

4. De Minimis Safe Harbor Election

        1) The de minimis limitation is set at $5,000 per-item limitation for taxpayers with an applicable financial statement (AFS) and a $500 per-item limitation for taxpayers without an AFS [Reg. 1.263(a)-1(f)].

        2) Under the regulations, the de minimis rule is a safe harbor that is elected annually by the extended due date of the original income tax return. The election is irrevocable.

        3) A statement described in Reg. 1.263(a)-1(f)(5) must be attached to the return.

5. Safe Harbor for Small Taxpayer with Buildings

    a. The election is made annually on a timely filed (including extensions) original income tax return. In the case of a partnership or S corporation that owns or leases a building, the partnership or S corporation makes the election. The election may not be made on an amended return unless permission to file a late election on an amended return is first obtained. The election is irrevocable (Reg. §1.263(a)-3(h)(6)).

6. Election to Capitalize Employee Compensation and Overhead

    a. A taxpayer may elect to capitalize amounts paid or incurred for employee compensation as amounts that facilitate the acquisition of property. The election to capitalize such costs is made separately for each acquisition and applies to employee compensation or overhead, or both. The election is made by capitalizing the elected amounts on the taxpayer's timely filed original return (including extensions) for the tax year the costs were paid or incurred. No election statement is required (Reg. §1.263(a)-2(f)(2)(iv)(B)).

7. Election to Capitalize in Accordance with Books

    a. Rather than going through a potentially complicated analysis to determine whether a trade or business expenditure is a currently deductible repair or a capitalized improvement, the final tangible property regulations allow a taxpayer to make an annual election to capitalize and depreciate as a separate asset any expenditure for repair and maintenance if the taxpayer capitalizes the expenditure on the books and records it regularly uses to compute its trade or business income.

    b. The election is made by attaching a statement to the taxpayer's timely filed original tax return (including extensions) for the tax year to which the election applies [Reg. §1.263(a)-3(n)(2)].

8. Partial Disposition Election

    a. The partial disposition election must be made by the due date (including extensions) of the original federal tax return for the tax year in which the portion of the asset is disposed of. No formal election statement is required. The taxpayer simply reports the gain or loss on the disposed portion of the asset on the return (Proposed Reg. §1.168(i)-8(d)(2)(ii)).

    b. The partial disposition election is not an accounting method except that the IRS allows certain retroactive elections by filing an accounting method change as explained in more detail below. However, all other changes to comply with Proposed Reg. §1.168(i)-8 for depreciable assets placed in service in a tax year ending on or after December 30, 2003, are accounting method changes. A taxpayer may also treat a change to comply with Proposed Reg. §1.168(i)- 8 for assets placed in service in a tax year ending on before December 30, 2003, as a change in accounting method (Proposed Reg. §1.168(i)-8(j)(5)).

9. Election to Capitalize Rotable, Temporary, or Standby Emergency Parts

    a. Capitalize and depreciate on timely filed original federal tax return (including extensions) for the tax year the asset is placed in service. No statement is required.