WHITE PAPER

# 2016 Tangible Property Regulations Update

During 2016, the IRS and Treasury issued additional guidance for taxpayer's who are required to comply with the new tangible property regulations. A brief summary of the additional guidance is provided below.

### Overview

For taxable years beginning on or after January 1, 2014, your clients are required to comply with the tangible property regulations. These regulations address every phase of an asset's life cycle from acquisition, to repair and maintenance or improvement, to disposition. To comply with the regulations, the IRS permitted your clients to file Forms 3115 with their 2014 tax return or in the case of a small taxpayer, to follow the procedures outlined in Rev. Proc. 2015-20. In addition, the IRS waived certain eligibility rules contained in the automatic method change procedures allowing your clients to make the same change in method of accounting more than once within a five-year period.

**The regulations provide new rules for the treatment of materials and supplies, new tests for improvements to tangible property, and new rules for the identification and disposition of assets.**

In addition, the regulations provide new elections and safe harbors that apply annually. The de minimis safe harbor election, small taxpayer safe harbor election, and the election to capitalize repairs for tax purposes are made by filing a statement with the tax return each year. The general asset account election is made by checking a box on Form 4562 each year. And the election to capitalize and depreciate rotable and temporary spare parts, the election to capitalize employee compensation and overhead, and the election to recognize the disposition of a portion of an asset are made by reporting on the tax return each year.

### Expired Provisions

Rev. Proc. 2015-20 allowing your small taxpayer clients to change their methods of accounting for tangible property without filing Forms 3115, only applied to the 2014 tax year. Under this procedure, your small taxpayer clients agreed to change their methods of accounting for tangible property on a cut-off basis without a Section 481(a) adjustment for prior tax years. By doing so, your clients agreed to forgo IRS audit protection for the prior method. Your clients who didn't change their methods of accounting for tangible property in 2014, or who haven't followed the new methods outlined in Rev. Proc. 2015-20, should file Forms 3115 with their 2016 tax return.

In addition, the late partial disposition election method change doesn't apply to tax years beginning after December 31, 2014. However, the late partial disposition election method change due to an IRS audit adjustment is still available.

## Rev. Proc. 2016-29

On May 5, 2016, the IRS and Treasury issued Rev. Proc. 2016-29 providing a new comprehensive list of automatic method changes. The IRS added new method changes, removed obsolete method changes, and modified other method changes.

One of the most significant changes affects your clients who used the property's tax basis to claim a federal income tax credit or who elected to apply Section 168(k)(4) to claim a refundable tax credit in lieu of bonus depreciation. The client must now use the non-automatic method change procedures to change accounting methods for tangible property which requires filing Form 3115 before the end of the year of change, paying a user fee, and receiving IRS consent before making the method change.

The new procedure is effective for all automatic Forms 3115 filed on or after May 5, 2016, for a year of change ending on or after September 30, 2015.

## IRS Audit Techniques Guide on Capitalization of Tangible Property

On September 14, 2016, the IRS issued a new Audit Techniques Guide (ATG) on Capitalization of Tangible Property which gives IRS agents a tool to help them identify potential tax issues related to compliance with the tangible property regulations. The ATG provides useful insight into the questions that examiners will ask and the documentation that they will request. Each chapter concludes with a list of "Audit Procedures", including specific questions to ask about the concepts explained in the chapter.

In preparation for an IRS audit, you should keep copies of all Form(s) 3115 filed in prior years, workpapers supporting any Section 481(a) adjustments, documentation supporting changes in accounting methods, and ensure that new accounting methods were adopted in 2014 and consistently followed in subsequent tax years. Your clients who haven't complied with these regulations should do so before being contacted by the IRS for exam. Forms 3115 filed before being contacted for IRS exam receive IRS audit protection for the former method for all prior tax years.

## Notice 2017-6

On December 20, 2016, the IRS issued Notice 2017-6 waiving the five-year eligibility rule that otherwise would prevent your client from using the automatic method change procedures to make the same change in method of accounting more than once within a five-year period. The waiver applies to automatic method changes for tangible property, depreciation, and disposition of assets filed for the 2016 tax year.

Under a transition rule, your clients who filed a non-automatic method change before December 20, 2016 may request an automatic method change if the request is still pending with the IRS National Office and your client follows the automatic method change procedures before the later of January 19, 2017, or the date the IRS National Office rules on the original request.

**PLANNING POINT**

The waiver of the five-year eligibility rule creates an opportunity for your clients to re-visit the work performed for the 2014 tax year to comply with the tangible property regulations. Any missed or corrective method changes should be filed with the 2016 tax return while the waiver of the five-year eligibility rule is in effect.

For example, your clients who continue to claim depreciation for duplicate assets, separately capitalized assets disposed of in prior tax years, or repairs capitalized before 2014 should consider following the automatic method change procedures outlined in Rev. Proc. 2015-13 and Rev. Proc. 2016-29 to deduct the remaining tax basis on the 2016 tax return. Automatic method changes may be filed up to six months after the original due date of the tax return, are filed with the tax return and separately with the IRS National office, IRS consent is automatic, there is no filing fee, and your client receives IRS audit protection for the former method for all prior tax years.