

Tangible Property Regulations Update

Presented by:

Iliana Malinov, CPA



Objectives

-  Overview of Tangible Property Regulations
-  Review key provisions
-  Consider practical steps for implementation and actions required
-  Understand CPA's professional responsibilities in complying with the regulations

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Tangible Property Regulations

<u>Regs. Section</u>	<u>Subject</u>
1.162-3	Materials and supplies
1.162-4	Repairs and maintenance
1.263(a)-1	Capital expenditures
1.263(a)-1(f)	De minimis safe harbor
1.263(a)-2	Amounts paid to acquire or produce tangible property
1.263(a)-3	Amounts paid for the improvement of tangible property
1.263(a)-3(e)	Unit of property
1.263(a)-3(h)	Small taxpayer building safe harbor
1.263(a)-3(i)	Routine maintenance safe harbor
1.263(a)-3(m)	Regulatory accounting method safe harbor
1.263(a)-3(n)	Book conformity safe harbor
1.168(i)-1	MACRS general asset accounts
1.168(i)-7	MACRS item and multiple asset accounts
1.168(i)-8	Dispositions of MACRS property
1.168(i)-8(d)	Partial disposition election

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Materials and supplies

HLB Provides a definition of materials and supplies

HLB Distinguishes between non-incidentals and incidentals

- Incidentals M&S are deductible in the taxable year in which the amounts are paid (provided taxable income is clearly reflected)
- Non-incidentals M&S are deductible in the year in which they are first used or consumed in the taxpayer's operations
- M&S may still need to be capitalized under Code Sec. 263A or as improvements to tangible property

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Expenditures to Acquire or Produce

■ General rule:

- An amount paid to acquire or produce real or personal tangible property, and
- For permanent improvements or betterments made to increase the value of any property, or for the restoration of property

must be capitalized and not currently deducted.

■ Transaction Costs

- Incurred in process of investigating acquisition
- Inherently facilitative costs

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Acquire or Produce

■ De minimis safe harbor election

- Applies to all property including M&S
- Allows tax accounting and financial reporting to be more aligned
- Does taxpayer have an Applicable Financial Statement
 - \$5,000
 - \$500
- 236A still applies
- Annual election

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Capitalize or Expense

- Amounts paid to improve a unit of property (UoP)
- What is an Improvement?
- Are we using appropriate Unit of Property?
 - Functional interdependence test
 - Special rules
- Buildings and building systems (9)

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Capitalize or Expense

- Safe Harbor for Small Taxpayers
 - Annual election
- Routine maintenance safe harbor
 - Routine maintenance deemed not to improve a UoP
 - Buildings and building systems - recurring activity taxpayer reasonably expects to perform more than once in 10 year period
 - Other UoP – more than once during class life (ADS) of UoP
 - **Non-election**
 - Annual irrevocable election to capitalize R&M available

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Dispositions

- The building, rather than its structural components, is the asset for disposition purposes
 - Improvements and additions are separate assets from the property improved
 - The taxpayer may claim a loss upon disposition of a component of a building or other asset without identifying the component as an asset prior to the disposition event
 - Alternatively, the taxpayer may forgo a loss upon the disposition of a structural component of a building
 - May reduce the administrative effort required to identify and track the cost and accumulated depreciation associated with the partially disposed of asset
 - May permit the taxpayer to deduct the cost of the replacement as a repair

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Partial Dispositions

- Unadjusted basis of disposed asset should be determined from taxpayers records or where impractical using any other reasonable method consistently applied to all portions of same asset.
- Election is made by reporting gain/loss on timely filed return for the year in which event takes place (not by method change)
- If, as a result of an audit, the IRS requires a taxpayer to capitalize an expenditure previously reported as a repair, the taxpayer can make the disposition election at that time by filing an application for change in accounting method

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Method changes

- Rev.Proc. 2014-16 – capitalize/expense issues some with 481(a) adjustment and some with cutoff.
- Examples:
 - Incidental and non-incident materials and supplies
 - Capitalizing amounts paid to acquire or produce property
 - Deducting “whether and which” costs for real property
 - Deducting repairs and maintenance or capitalizing improvements – includes a change to the method of identifying the UOP or building structure or building systems

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Method Changes

- Rev. Proc. 2014-57– GAA, MAA and dispositions
- Rev. Proc. 2014-54 – provides a late partial disposition election for retirements that occurred prior to 2012
 - Filed as a method change via Form 3115
 - After the 2014 tax year, no late partial disposition elections will be permitted
- What about dispositions during 2012 and 2013?

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Elections

- De minimis safe harbor election requires an annual statement in the tax return
- Election to capitalize compensation and overhead is made by capitalizing in return
- Election to capitalize repairs consistent with books is made in an annual statement in the tax return
- The small taxpayer safe harbor election is made in an annual statement in the tax return
- The partial disposition election is made by recognizing the gain or loss

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Failure to comply

- Permanently missed deductions: R&M or depreciation
- Incorrect Unit of Property
- Automatic change in 2014 → Advance consent/ PLR later
- Increased likelihood of IRS examination
- Missed partial year dispositions
- Professional practice issues
 - No materiality threshold under Cir 230
 - ASC 740-10 liability computation and UTP disclosure
- AICPA recommendation to IRS (Oct 9, 2014)

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Implementation

- Review of clients fixed assets file
 - Incorrect methods/lives under Rev. Proc. 87-56
 - Incorrect Unit of Property
 - Capitalize or Expense
 - Partial dispositions
- Educate client on issues, opportunities and risks related to failure to comply
- Discuss with client materials and supplies, routine maintenance and capitalization policy
- Attempt to incorporate in audit/tax planning meetings if not already addressed
- Create a systematic approach to analysis and 3115 preparation.

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QUESTIONS?

**How is everyone else addressing the
TPRs?**

This presentation contains information in summary form and is therefore intended for general guidance only. It is not intended to be a substitute for detailed research or the exercise of professional judgment.

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