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Final Repair/Capitalization/MACRS Regulations Update

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Special Report

HIGHLIGHTS

- Simplified De Minimis Safe Harbor for More Businesses
- Routine Maintenance Safe Harbor Extended to Buildings
- New Book Capitalization Safe Harbor Election
- GAAs Out – Partial Disposition Elections In
- Betterments/Restorations Must Be Capitalized
- Accounting Method Changes Required in 2014
- Guidance on Completing Form 3115

INSIDE

Final Repair/Capitalization/ MACRS Regulations Create New Deadlines/ Election Opportunities

After several years of struggle, the IRS at long last completed its "repair regulations" project, including the closely related Modified Accelerated Cost Recovery System (MACRS) rules in 2014 dealing with dispositions and MACRS general asset, multiple asset, and item accounts. The IRS also completed guidance in 2014 related to accounting method changes that must be filed to comply with accounting methods described in any of the final regulations where a taxpayer's current accounting method now differs.

IMPACT. *The final regulations can affect virtually every business since virtually all businesses have tangible assets. Many elections and accounting method change deadlines related to the repair and MACRS final regulations are keyed to tax years starting after December 31, 2013. This deadline creates immediate compliance challenges for businesses on a calendar year that are going into the filing season for 2014 returns. Many businesses reportedly are only now scrambling in get in front of these deadlines.*

OVERVIEW

Overall, the final repair regulations (T.D. 9636, Sept. 13, 2013) are similar to the temporary repair regulations (T.D. 9564, Dec. 23, 2011). However, they differ sufficiently that each business that previously applied the temporary regulations should examine whether they continue to apply under the final regulations with respect to their particular situations. Whether or not the temporary regulations were previously applied, all businesses must now comply with rules that the final regulations make mandatory in tax years beginning on or after January 1, 2014. If the final repair regulations require an accounting method that is different from an accounting method that a taxpayer currently uses an accounting method change must usually be filed for the 2014 tax year. A similar rule applies to the MACRS final regulations that are mandatorily effective in tax years beginning on or after January 1, 2014.

The final repair regulations provide several favorable surprises, including:

- A revised and simplified de minimis safe harbor under Reg. §1.263(a)-1(f);
- The extension of the safe harbor for routine maintenance to buildings;
- A new annual election for smaller taxpayers to immediately deduct some improvement costs for buildings;
- A new annual election to capitalize repair costs that are capitalized on the taxpayer's books and records; and
- Refined criteria for defining betterments and restorations to tangible property.

Also, in response to a chorus of criticism, final MACRS regulations (T.D. 9689, August 14, 2014) eliminate a key feature of the temporary MACRS regulations that made the recognition of loss on the retirement of a structural component elective only if the building was placed in a general asset account (GAA). This switch means that most taxpayers who filed accounting method changes to make retroactive elections to place buildings in a GAA in reliance on the temporary regulations will

want to take advantage of accounting method changes that allow the revocation of those GAA elections and the preservation of losses claimed on structural components of those buildings, as explained later.

Form 3115, Change in Accounting Method: As an essential part of many …but not all… compliance and elective requirements and opportunities arising from the regulations is filing Form 3115, Application for Change in Accounting Method. Rev. Proc. 2014-16, as a companion to the final repair regulations, provides the principal guidance, on when to file …and when not to file… Form 3115 for these purposes. Rev. Proc. 2014-54 similarly provides accounting method changes to comply with the final MACRS regulations, effective for changes filed on or after September 18, 2014.

Effective dates/deadlines: The final repair and final MACRS regulations must be followed by all taxpayers starting in tax years beginning on or after January 1, 2014. However, the final regulations may at a taxpayer's discretion be first applied to a tax year beginning on or after January 1, 2012, and before January 1, 2014… or the taxpayer may apply the earlier repair and MACRS regulations instead. In all instances, application of these regulations require adherence to specific compliance and election deadlines.

IMPACT. *Applying the final repair and MACRS regulations to a tax year beginning on or after January 1, 2012 and before January 1, 2014, usually requires the timely filing of accounting method changes for the tax year and the making of timely elections allowed by the regulations. The deadlines for filing accounting method changes and making regulatory elections for the 2012 tax year have expired. The filing deadlines for the 2013 tax year have also expired except for 2013/2014 fiscal-year taxpayers with a fiscal-year beginning near the end of 2013. Consequently, most taxpayers will begin to apply the final regulations by filing accounting method changes for their 2014 tax year.*

MATERIALS AND SUPPLIES

Key changes made by the final repair regulations with respect to the treatment of materials and supplies include:

- $100 per-item threshold for materials and supplies is increased to $200;
- Standby emergency spare parts are included in definition of material and supplies;
- Election to capitalize materials and supplies now limited to rotable, temporary, and standby emergency spare parts; and
- Materials and supplies are subject to de minimis safe harbor.

> "Many elections and accounting method change deadlines related to the repair and MACRS final regulations are keyed to tax years starting after December 31, 2013. This deadline creates immediate compliance challenges…"

Under the final regulations, the cost of acquiring material and supplies is generally deducted in the tax year the materials or supplies are first used or consumed (Reg. §1.162-3(a)(1)). Gain on the disposition of a material or supply is ordinary income (Reg. §1.162-3(g)).

Incidental materials and supplies are deducted in the tax year their cost is paid or incurred provided taxable income is clearly reflected. 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.

Additional changes/clarifications. The final regulations also provide that:

- "Standby emergency parts" are materials and supplies that are deductible in the year used or consumed;
- Rotable and temporary spare parts are materials and supplies that are deducted in the year used or consumed unless the taxpayer elects the optional method of accounting;
- A rotable or temporary spare part is considered used or consumed in the tax year that it is disposed of;
- A standby emergency spare part is considered used or consumed when it is installed; and
- A taxpayer may use an optional accounting method and deduct the cost when the part (except for a stand-by emergency part) is first installed.

IMPACT. *The final regulations require a taxpayer electing the de minimis safe harbor (see, below) to apply the safe harbor to amounts paid for all materials and supplies that meet the requirements for deduction under the safe harbor. The requirement, however, does not apply to rotable, temporary, and standby parts that the taxpayer elects to capitalize and depreciate or rotable and temporary spare parts for which the taxpayer properly uses the optional method of accounting. The cost of materials and supplies is usually deducted in the year used or consumed. Under the safe harbor, the cost of the de minimis items is deducted in the year paid or incurred.*

Election to capitalize and depreciate rotable, temporary, and standby parts. The temporary regulations generally allowed a taxpayer to elect to capitalize and depreciate any type of material and supply other than rotable and temporary spare parts for which the optional method was elected. The final regulations restrict the election to rotable and temporary spare parts for which the optional method is not elected and to standby emergency spare parts (Reg. §1.162-3(d)). The election also does not apply to a rotable, temporary, or emergency spare part that will be used as a component of a material or supply that is a unit of property costing less than $200, or a component of a unit of

property with an economic useful life of less than 12 months.

Accounting method changes: A change to comply with the final regulations relating to materials and supplies is a change in method of accounting. Rev. Proc. 2014-16 provides for the following specific changes relating to materials and supplies.

- Change to deducting the cost of non-incidental materials and supplies to the year used or consumed (change 186);
- Change to deducting the cost of incidental materials and supplies to the year paid or incurred (change 187);
- Change to deducting the cost of non-incidental rotable and temporary spare parts to the year disposed of (change 188);
- Change to the optional method for rotable and temporary spare parts (change 189).

IMPACT. *The first three methods 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 Code Sec. 481(a) adjustment.*

DE MINIMIS SAFE HARBOR ELECTION

Key changes made by the final repair regulations with respect to the de minimis safe harbor election include:

- Ceiling limitation is replaced with $500/$5,000 per-item limit ($500 for taxpayers without an applicable financial statement (AFS));
- Taxpayers without applicable financial statement (AFS) qualify;
- Safe harbor is an election and not an accounting method; and
- No election to exclude materials and supplies.

The final regulations make taxpayer-friendly changes to the de minimis expensing rule originally provided in the temporary repair regulations.

As revised by the final regulations, the safe harbor provides that a taxpayer may not capitalize amounts paid (cash basis taxpayer) or incurred (accrual basis taxpayer) for:

- The acquisition of a unit of tangible property,
- The production of a unit of property; or
- A materials or supply.

That costs $5,000 or less (for a taxpayer with an AFS) or $500 or less (for taxpayer without an AFS) (Reg. §1.263(a)-1(f)(1)). If a taxpayer's book accounting procedure sets a lower limit, the lower limit applies. If a higher limit is set by the accounting procedure then the $5,000 or $500 limit, as applicable, applies.

A taxpayer with an AFS must have a written accounting procedure for non-tax purposes in place at the beginning of the tax year of election that requires book expensing of amounts costing less than a specified amount. Taxpayers without an AFS must also have an accounting procedure in place but it need not be written.

Making the election. Under the final 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. The election is made by a partnership or S corporation, not by the partners or shareholders.

COMMENT. *A statement described in Reg. §1.263(a)-1(f)(5) must be attached to the return. The de minimis safe harbor is not an accounting method under the final regulations and therefore requires no Form 3115. A late election may be made on an amended return only with IRS consent.*

Additional issues. Additional issues surrounding the de mininimis safe harbor election addressed in the final regulations include:

- Eligible taxpayers;
- Property with an economic useful life of 12 months or less;
- Production and acquisition of unit of property;
- "AFS" Defined;
- Consolidated groups; and
- Coordination of UNICAP rules.

UNIT OF PROPERTY

The final regulations make no significant changes to the temporary regulations with respect to a "unit of property." Nevertheless, the significance of determining a "unit of property" remains. The categorization of an expenditure as a capitalized improvement or a deductible repair is greatly affected by the size of the unit of property that is being worked on. The final regulations provide specific definitions for a unit of property in the case of buildings, and a general rule (the functional interdependence test) for other types of property.

COMMENT: *Although a building is defined as a unit of property for other purposes, the determination of whether an expenditure is deducted as a repair or capitalized as an improvement is made by treating each of nine building "systems" as a separate unit of property. These building systems include:*

1) *Heating, ventilation, and air conditioning (HVAC) 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) *Other structural components that are specifically designated as building systems in future published guidance (Reg. §1.263(a)-3(e)(2)(ii)).*

IMPACT. *Generally, the larger the unit of property is, the more likely it is that costs will be characterized as a repair rather than a capital expenditure.*

Types of assets involved in dealing with a unit of property addressed in the final regulations include:

- Buildings and building systems;
- Leased buildings;
- Condominiums and cooperatives;
- Personal and other real property;
- Improvements to unit of property;
- Components with different property classes;
- Plant property; and
- Network assets.

Accounting method change. A taxpayer using a unit-of-property definition that differs from the definition in the final regulation is using an improper accounting method and is required to file Form 3115 (see change 184 of Rev. Proc. 2014-16).

AMOUNTS PAID TO IMPROVE TANGIBLE PROPERTY

Key changes made by the final repair regulations with respect to the treatment of amount paid to improve tangible property include:

- Reorganization and clarification of the types of activities that constitute betterments;
- Modification of "refresh" examples to better illustrate definition of an improvement; and
- A compromise solution for casualty loss/repair deduction controversy under the temporary regulations.

The heart of the "repair regulations" — Reg. §1.263(a)-3 — provides rules for distinguishing between expenditures that are repairs and expenditures that are capital improvements. Broadly speaking this portion of the regulations provides a framework that integrates the basic rules and concepts that have been developed over the years in court cases and IRS guidance for distinguishing capital expenditures from currently deductible repairs.

IMPACT. *Bright-line tests are markedly absent. Consequently, facts and circumstances will continue to play an important role in distinguishing repairs from improvements.*

Additional issues. Additional issues involved in dealing with a unit of property addressed in the final regulations include:

- Clarifying what is a capitalized betterment;
- Providing a clearer delineation between "refresh" costs that are deductible and those that must be capitalized;
- Defining what is a restoration;
- Allowing a taxpayer to claim a repair deduction if the restoration expenditures exceed the adjusted basis of the property prior to reduction by the casualty loss or insurance reimbursement; and
- Providing that the cost of replacing a part or combination of parts that comprise a major component or a substantial structural part of a unit of property is a capitalized restoration .

CAUTION. *Although the definition of materials and supplies includes "components acquired to maintain, repair, or improve a unit of tangible property," the rule that allows the cost of a component to be deducted as a material or supply in the year used or consumed does not apply if the component improves a unit of property (Reg. §1.263(a)-3(c)(2)). Consequently, the cost of a major component must be capitalized as an improvement under the rules for restorations and may not be deducted as a material or supply. Similarly, no deduction may be claimed for the cost of an item that is a material or supply if the material or supply replaces a component for which a retirement loss deduction is claimed, because the cost of the replacement is considered a restoration when a loss deduction is claimed.*

Accounting method change. 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 deducted amount if it had been capitalized 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.

COMMENT. *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.*

ROUTINE MAINTENANCE SAFE HARBOR

Key changes made by the final repair regulations with respect to the routine maintenance safe harbor include:

- Expansion of the routine maintenance safe harbor to include buildings; and
- Exclusion of network assets from the safe harbor.

The costs of performing certain routine maintenance activities on a unit of property, including a building structure or one of the enumerated building systems, are deductible under a routine maintenance safe harbor (Reg. §1.263(a)-3(i)). This safe harbor is not elective.

Under the safe harbor, an amount paid is deductible if it is for ongoing activities that, as a result of the taxpayer's use of the unit of property, the taxpayer expects to perform to keep the unit of property in its ordinarily efficient operating condition. In the case of a building, the building structure and each building system is treated as a separate unit of property.

IMPACT. *The maintenance must be attributable to the taxpayer's use of the*

property. Thus, the safe harbor does not apply to scheduled maintenance performed shortly after purchasing a used machine or an existing building.

Accounting method changes. The routine maintenance safe harbor is considered an accounting method and requires a full Code 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 under Rev. Proc. 2014-16, a taxpayer files Form 3115 using change 184.

ELECTION TO CAPITALIZE IN ACCORDANCE WITH BOOKS

A new safe harbor under the final repair regulations allows a taxpayer to conform its tax capitalization policy to its book capitalization policy (Reg. §1.263(a)-3(n)). 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 repair 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.

The election applies to all amounts paid for repair and maintenance of tangible property that are treated as capital expenditures on the taxpayer's books and records for the tax year that is covered by the election. These amounts are not treated as amounts paid for repair or maintenance and, thus, are not currently deductible.

IMPACT. In effect, the election is a safe harbor, because the IRS cannot challenge an electing taxpayer's characterization of a repair expense as a capital expenditure. The election, however, works in only one direction. Amounts that are expensed as repairs on the taxpayer's books may not be deducted as repairs for tax purposes under the protection of the book capitalization safe harbor. Repair deductions claimed for tax purposes must be allowable under the standards set forth in the repair regulations.

Accounting method changes. 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. To change from an improper capitalization of a repair expense and from an improper deduction of a capital expenditure, taxpayers use change 184 of Rev. Proc. 2014-16.

SAFE HARBOR FOR SMALL TAXPAYERS WITH BUILDINGS

A new safe harbor for small taxpayers with buildings allows taxpayers with $10 million or less in annual gross receipts to deduct a limited amount of improvement expenditures on qualifying buildings (Reg. §1.263(a)-3(h)).

IMPACT. *Small taxpayers complained that they could not afford to collect and maintain the documentation necessary to apply the improvement rules in the temporary regulations to their buildings. In response, the final regulations include an annual safe harbor election for each building a taxpayer owns or leases that has an unadjusted basis no greater than $1 million (Reg. §1.263(a)-3(h)(3)).*

Under the safe harbor, the small taxpayer is not required to capitalize improvements if the total amount paid for repairs, maintenance, and improvements during the year does not exceed the lesser of $10,000, or two percent of the unadjusted basis of the building.

COMMENT. *The IRS may adjust the $10,000, two percent, and $1 million amounts in the future through published guidance.*

ELECTIONS UNDER FINAL REPAIR REGS

Election	Accounting Method	Due Date
Election to Capitalize Rotable, Temporary, or Standby Emergency Parts	NO	Capitalize and depreciate on timely filed original federal tax return (including extensions) for the tax year the asset is placed in service; no statement required
Partial Disposition Election	NO*	Report gain/loss on timely filed original return (including extensions) in year of disposition; no statement required
De Minimis Safe Harbor Election	NO**	Attach statement to timely filed return (including extensions) each year
Election to Capitalize Employee Compensation or Overhead	NO	Treat amounts to which election applies as capitalized on timely filed original return (including extensions) for which amounts are paid or incurred; no statement required
Election by Small Taxpayer to Deduct Building Improvements	NO	Attach statement to timely filed return (including extensions) each year
Election to Capitalize Repair and Maintenance per Books	NO	Attach statement to timely filed return (including extensions) each year

* Accounting method change may be filed to make late partial disposition election for pre-2012 dispositions; Accounting method change or amended return may be filed to claim a loss on certain 2012 or 2013 partial dispositions

** *De minimis* safe harbor is an accounting method change under the temporary regulations

Eligible building property. "Eligible building property for purposes of this safe harbor is defined as each unit of property that (i) is a building (including structural components and building systems) or portion of a building that is a separate unit of property under the regulations, such as leased office space or an individual condominium or cooperative unit, and (ii) has an unadjusted basis of $1 million or less.

Election deadline. The election to come under this small taxpayer safe harbor 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. An election statement is required.

COMMENT. *The safe harbor for small taxpayers is not considered an accounting method change.*

AMOUNTS PAID TO ACQUIRE OR PRODUCE TANGIBLE PROPERTY

Although not directly related to the "repair v. capitalization" issue, the final regulations include rules explaining the types of costs that must be capitalized because they are "amounts paid to acquire or produce a unit of tangible property" (Reg. §1.263(a)-2). The final regulations make no significant changes to the temporary regulations relating to the requirements to capitalize amounts paid to acquire or produce a unit of real or personal property. However, they expand the regulations' reach by, among other things, defining a contingency fee and providing that such fees are capitalized only if property is ultimately acquired.

COMMENT. *A taxpayer must capitalize amounts paid or incurred to acquire or produce a unit of real or personal property, including leasehold improvement property, land and land improvements, buildings, machinery and equipment, and furniture and fixtures.*

Additional issues. Additional issues covered by the final regulations in dealing with the determination and treatment of amounts paid to acquire or produce tangible property involve:

- Work prior to placing property in service;
- Recovery of capitalized amounts;
- Facilitative acquisition costs;
- Facilitative amounts for failed acquisitions;
- Pre-decisional costs for real property;
- Election to capitalize employee compensation and overhead costs;
- Moving and reinstallation costs; and
- Defending or perfecting title.

COMMENT. *An election to capitalize employee compensation and overhead is not a change in accounting method.*

Accounting method changes. Accounting method changes to comply with these rules are covered by change 192 and 193 of Rev. Proc. 2014-16.

DISPOSITION OF MACRS PROPERTY

A new partial disposition election under the final regulations allows taxpayers to treat the retirement of structural components, components of structural components, and components and subcomponents of assets such as machinery as a disposition on which gain or loss (usually loss) is recognized (Reg. §1.168(i)-8(d)). Under the temporary regulations a taxpayer was required to recognize gain or loss on the retirement of a structural component of a building that was not in a GAA and was allowed to recognize gain or loss on the retirement of a component of a section 1245 property (e.g., machine) if it defined the component as a separate asset for disposition purposes (Temp. Reg. §1.168(i)-8(d)).

COMMENT. *Taxpayers may file an accounting method change to make a late partial disposition election for partial dispositions of assets that occurred in tax years beginning before January 1, 2012 (change 196 of Rev. Proc. 2014-54). This change must be filed for no later than the 2014 tax year. Some taxpayers may have filed accounting method changes that applied the temporary regulations for purposes of claiming retirement losses on structural components of a building or components of other assets for pre-2012 dispositions. These losses can only be preserved by filing another accounting method change (change 196) to make a late partial disposition election.*

Issues addressed in the final regulations include, among others:

- When a disposition of MACRS property occurs; and
- Defining "asset" for disposition purposes, under which each building, condo unit, or cooperative unit, including its structural components, is generally treated as an asset.

Additions and improvements. A capitalized improvement or addition added to an asset after the taxpayer places the asset in service is a separate asset for depreciation purposes (Reg. §1.168(i)-8(c)(4)(ii)(d)). Since the addition or improvement is a separate asset, a loss must be recognized on its retirement. The partial disposition election does not apply because an entire asset is disposed of.

EXAMPLE: *Say the roof of a building is replaced and capitalized as an improvement. The replacement roof is considered a separate asset because it is an addition or improvement. It is not, however, a separate unit of property. The building, including the new roof, is a unit of property. When the new roof is removed, a loss must be recognized because the entire asset has been disposed of. The partial disposition election is not necessary and does not apply. The partial disposition election, however, could apply to a portion of the replacement roof, such as its shingles, if they are later replaced.*

The shingles would then be considered a separate depreciable asset.

Partial disposition election. A disposition of a portion of an asset is generally treated as a disposition on which gain or loss is realized only if the partial disposition election is made. However, the final regulations treat the following dispositions of a portion of an asset as dispositions whether or not a taxpayer makes a partial disposition election (Reg. §1.168(i)-8(d)(1)):

- Sale of a portion of an asset;
- Disposition of a portion of an asset as the result of a casualty;
- Disposition of a portion of an asset for which gain (determined without regard to depreciation recapture) is not recognized in a like kind exchange or involuntary conversion; and
- Transfer of a portion of an asset in a "step-in-the-shoes" nonrecognition transaction described in Code Sec. 168(i)(7)(b).

COMMENT. *The partial disposition election may be made for any portion of a disposed-of asset regardless of how small the portion is. However, no repair deduction can be claimed with respect to the new replacement component if the election is made (Reg. §1.263(a)-3(k)(1)).*

Computing remaining adjusted basis. If a taxpayer makes the partial disposition election or the transaction is otherwise considered a partial disposition (because it is a sale, a disposition as the result of a casualty event, etc.), the adjusted basis of the disposed portion of the asset at the time of disposition needs to be computed to determine gain or loss. Any reasonable method may be used to make this determination if it is not practicable to do so using the taxpayer's books and records (Reg. §1.168(i)-8(f)).

MACRS GENERAL ASSET ACCOUNTS

The final Modified Accelerated Cost Recovery System (MACRS) regulations reverse the most significant change made by the earlier temporary regulations to the general asset account (GAA) rules. Specifically, the expansion of the qualifying disposition election to virtually any disposition, which allowed a taxpayer to elect to recognize a loss on the disposition of an asset in a GAA including retirements of structural components, is eliminated. In addition, only a few types of partial dispositions of assets are made subject to a new mandatory gain or loss recognition rule. These include the same types of partial dispositions for which gain and loss recognition is mandatory under the rules that apply to dispositions outside of a GAA, (i.e., sales, casualty losses, etc.) (Reg. §1.168(i)-1(e)).

> "A taxpayer may make an irrevocable election to include assets in an MACRS GAA. The election must be made by the due date (including extensions) of the return for the tax year in which the assets included in the GAA are placed into service."

IMPACT. *Some taxpayers filed accounting method changes to retroactively elect to place buildings that were in service in a tax year beginning before January 1, 2012 into a GAA. This was done to take advantage of the rule in the temporary regulations that allowed a taxpayer to elect whether or not to claim a retirement loss on the disposition of a structural component provided the building was in a GAA. Under the temporary regulations, the retirement of a structural component of a building that was not in a GAA resulted in a mandatory loss. The final MACRS regulations changed the rules by generally not allowing taxpayers to claim a retirement loss on structural components of a building in a GAA and instead allowing a retirement loss if a building is not in a GAA by making the partial disposition election. Since the GAA advantage for buildings is now removed, the IRS allows a taxpayer to file an accounting method change to revoke any retroactive GAA elections (change 197 of Rev. Proc. 2014-54). The change must be filed for no later than the 2014 tax year. The revocation may also be made for retroactive elections to place section 1245 property in a GAA as well as for timely GAA elections that were made for buildings and section 1245 property placed in service in a tax year beginning in 2012 or 2013. If a taxpayer claimed a retirement loss on a structural component of a building or other asset that it placed in a GAA, in addition to revoking the election, it must also file an accounting method change to make a late partial disposition election to preserve that loss (change 196).*

Broad coverage. The final MACRS regulations cover a broad range of issues related to new GAA rules, including:

- Rules for grouping assets into a GAA;
- Depreciation computations and allowances on a GAA;
- Disposition of assets from a GAA;
- Disposition of a portion of an asset;
- Disposition defined;
- Elections to recognize gain or loss in a qualifying disposition;
- Demolition of a building in a GAA; and
- Identifying assets disposed of from a multi-item GAA.

GAA election procedures. A taxpayer may make an irrevocable election to include assets in an MACRS GAA. The election is made separately by each person owning an asset to be placed in a GAA. For example, the election is made by each member of a consolidated group, each partnership, or each S corporation. The election must be made by the due date (including extensions) of the return for the tax year in which the

assets included in the GAA are placed into service (Reg. §1.168(i)-1(e)).

Accounting method changes. An election to recognize gain or loss upon the disposition of the last asset in a GAA or the election to recognize gain or loss upon a qualifying disposition is not a change in accounting method. However, all other changes to comply with Reg. §1.168(i)-1 for depreciable assets placed in service in a tax year ending on or after December 30, 2003, require accounting method changes to the extent the final regulations prescribe an accounting method that differs than the taxpayer's accounting method (Reg. §1.168(i)-1(m)(5)).

Amended return option. 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)).

IMPACT. *This means that no Form 3115 is filed and no Code Sec. 481(a) adjustment (or a similar cumulative depreciation adjustment) is required or permitted. A taxpayer who follows this 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).*

SPECIAL RULES FOR COMPLETING FORM 3115

The detailed description of the taxpayer's present and proposed accounting methods required by line 15 of Form 3115, Application for Change in Accounting Method, should include a citation to the specific portion of the repair regulations that describes the method to which the taxpayer is changing. For example, a taxpayer adopting the safe harbor for routine maintenance under the final regulations should cite Reg. §1.263(a)-3(i) (change 184). Similarly, if a taxpayer is filing a change under the final regulations to capitalize amounts previously deducted as a repair expense that are actually betterment, restoration, or adaptions costs, Reg. §1.263(a)-3(j), (k), or (i), respectively, should be cited (change 184).

In another common situation, a taxpayer may need to change its definition of a unit of property for personal property and/or buildings either as separate change on Form 3115 (change 184 or on the same Form with a change from deducting to capitalizing improvement costs (also change 184). The Form 3115 must include a detailed description of the unit of property under the present system and under the proposed change, including a citation to the portion of final Reg. §1.263(e)-3(e) under which the unit of property is permitted.

Streamlined Form 3115. Rev. Procs. 2014-16 and 2014-54 provide "reduced filing requirements for small taxpayers." A small taxpayer is a taxpayer with average annual gross receipts of $10 million or less during the preceding three tax years. The reduced filing requirements only exempt filers from completing certain lines of Form 3115 and do not affect the detailed computation of any required Code Sec. 481(a) adjustment.

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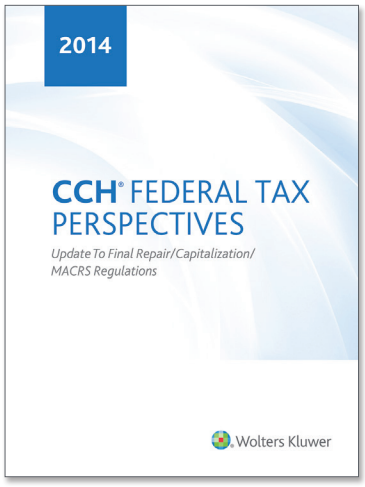

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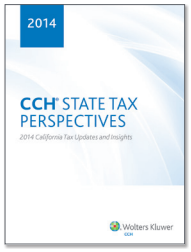

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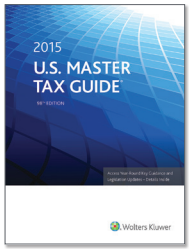

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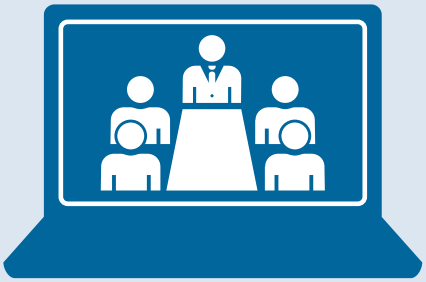

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