NON-DEPRECIABLE TO DEPRECIABLE IS IT AUTOMATIC?

The Rev Proc can be confusing. A client recently asks: Is the change from treating an asset as non-depreciable to depreciable considered an automatic change?

The change from treating an asset as non-depreciable to depreciable is an automatic accounting method change under Rev. Proc. 2017-30, §6.01(1)(a) & §1.446-1(e)(2)(ii)(d)(2). Rev. Proc. 2017-30, §6.01(1)(a) provides that amongst other requirements, Accounting Method Change #7 applies to a taxpayer making a change in method of accounting under §1.446-1(e)(2)(ii)(d). §1.446-1(e)(2)(ii)(d)(2) provides that a change in the treatment of an asset from nondepreciable to depreciable, or vice versa, is a change in method of accounting.

Just a reminder, there is a scope limitation that prohibits multiple automatic changes within the same 5-year period, so if the client is going to start depreciating an asset that they might want to have a cost segregation study performed on, they'll need to have the study done at the same time.

In that same Rev. Proc. 2017-30, there are a list of changes which are excluded from an automatic designation. Specifically Sec. 6.01(1)(c)(xii). The use of "both" and the use of the phrase "requiring an election" are the keys.

The property will have to be depreciated based on whatever elections were made for the original in-service year. If the taxpayer elected out of bonus depreciation under §168(k)(7) for any class of property for the original in-service year, then you're stuck with that election. Likewise, you couldn't elect out of bonus for this property if you didn't make that election originally.

Similarly, let's say the property you're researching this for is nonresidential real property. Under §168(g)(7), you would normally be able to elect ADS on that property individually. However, since it's an election, you can't make it for this property.

EXAMPLE
Scarpello Consulting has filed a 3115 making the change under 6.01 for a group of buildings that were somehow placed on the client's books, but never depreciated. We calculated the depreciation on the assets based on the elections that were in place for the original in-service year. This is something we've done numerous times in the past, and we've yet to be questioned by IRS.

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Think about it like this; under any other reading of 2017-30, §6.01(1)(c)(xii), you couldn't make an automatic accounting method change for a change from treating the cost of the property as non-depreciable to depreciable because the act of depreciating the property also requires the adoption of a method of accounting for the depreciation under one of the listed code sections.

If that were the outcome the drafters had desired, they could have simply written "(xii) any change in method of accounting involving a change from treating the cost or other basis of the property as non-depreciable or non-amortizable property to treating the cost or other basis of the property as depreciable or amortizable property."

The extra language had to have some purpose or else it would be surplusage, and the tax court (or any court for that matter) would tend to follow the textual canon of interpretation against surplusage.

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