

Regulations and Recent Developments-Repair Regulations

July 25, 2014

On September 13, 2013, the IRS released final regulations providing comprehensive guidance regarding amounts paid to acquire, produce or improve tangible property and what can be expensed as repairs and maintenance or materials and supplies. These regulations are commonly referred to as the “repair regs.” All taxpayers must comply with these regulations for the first tax year beginning on or after January 1, 2014, however taxpayers have a few options for earlier tax years that begin on or after January 1, 2012 and on or before January 1, 2014:

- Continue with the existing method of accounting.
- Adopt the 2011 temporary regulations.
- Early adopt the final regulations.

There are three categories of changes under the final regulations:

- Changes that are required and are retroactive, with full adjustments under Code Sec. 481(a) such as capitalizing and depreciating improvements to a unit of property and depreciation of leasehold improvements.
- Required changes with a modified or prospective Code Sec. 481(a) adjustment beginning in 2014. Examples of a modified 481(a) adjustment would be deducting incidental materials and supplies and a change from a permissible to permissible method of depreciation.
- Elective changes that do not require any adjustments under Code Sec. 481. Annual elections include the de minimis safe harbor and the election to deduct building improvements by a small taxpayer.

At the time the final regulations were issued, two revenue procedures (“Rev.Proc.”) addressing the required automatic changes were left in place with a notice that new procedures would be forthcoming. On January 24, 2014 Rev. Proc. 2014-16 was issued, followed by Rev. Proc. 2014-17 on February 28, 2014.

Revenue Procedure 2014-16

Rev. Proc. 2014-16 supersedes Rev. Proc. 2012-19 in the final repair regulations. It provides automatic method change procedures regarding treatment of materials & supplies and costs to acquire, maintain or improve tangible property.

The automatic accounting method changes that can be made under this Rev. Proc. relating to the final repair regulations are the following:

- Repair and maintenance amounts.
- Regulatory accounting method.
- Non-incidentals materials and supplies.
- Incidentals materials and supplies.
- Non-incidentals rotatable and temporary spare parts.
- Optional method for rotatable and temporary spare parts.
- Commissions and other transaction costs that facilitate the sale of property (dealer).
- Commissions and other costs that facilitate the sale of property (non-dealer).
- Capitalizing acquisition or production costs.
- Costs for investigating or pursuing the acquisition of real property.

Taxpayers no longer have to conform to the uniform capitalization (“Unicap”) rules under Section 263A in order to make the automatic method changes. This however does not remove the requirement to comply with the Unicap rules. Taxpayers may now use the automatic procedures to change to a reasonable allocation method for allocating direct and indirect costs to self-constructed property.

Automatic accounting method change procedures generally can’t be made when a taxpayer is under examination or has changed its accounting method on the same item within the last five years. These scope limitations are waived for accounting method changes under Rev. Proc. 2014-16, but only for taxpayers who make the change(s) for taxable years beginning before January 1, 2015.

Revenue Procedure 2014-17

The IRS issued Rev. Proc. 2014-17 on February 28, 2014. This Rev. Proc. supersedes Rev. Proc. 2012-20 and provides guidance for the automatic change procedures regarding dispositions and general asset account treatment under the re-proposed regulations. Final regulations addressing dispositions are expected to be released later this year. The automatic change procedures covered are:

- Depreciation of leasehold improvements.
- Permissible to permissible method for depreciation of MACRS property.
- Disposition of a building or structural component.
- Disposition of other tangible depreciable assets.
- Late partial disposition election.
- Partial dispositions of tangible depreciable assets.
- General asset account elections.

The temporary regulations covering dispositions allowed taxpayers to recognize gain or loss on the disposition of an asset within a general asset account (“GAA”). In a complete reversal from these temporary regulations, a structural component of a building is no longer considered a separate asset. Partial dispositions are not permitted in a general asset account. Taxpayers who made GAA elections under the temporary regulations can revoke this election by filing Form 3115.

Partial dispositions are no longer considered automatic changes but instead are made by making an election on a timely filed return. Thus, taxpayers will no longer have the ability to make these changes on a retroactive basis on Form 3115 as they have in the past. Taxpayers may file a late disposition election but it must be filed prior to the extended due date of the 2013 return. Taxpayers who have already filed their 2013 return may amend, but only up until the extended due date of the return.

The partial disposition election cannot be made if the taxpayer does not own the entire asset as of the beginning of the year of change. Taxpayers who buy a building and remodel in the same year will be precluded from disposing of the old finishes. If a remodel is performed in later years, a partial disposition election can be made (assuming the taxpayer has not elected GAA treatment) to recognize a loss on the disposed assets.

Final guidance on dispositions is expected in the fall of 2014.