

Chapter 2: Capitalization vs. Repair Review

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Note. Corrections were made to this workbook through January of 2024. No subsequent modifications were made. For terms used in this chapter, see the **Acronyms and Abbreviations** section following the index.

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INTRODUCTION

One of the more complex areas of accounting and taxation is knowing whether to expense a purchase immediately or to recognize the expense over time through depreciation or amortization. Whether to write off certain business expenses or depreciate them requires critically analyzing facts and circumstances. IRC §162(a) allows taxpayers engaged in a trade or business to deduct “ordinary and necessary” business expenses. At the same time, IRC §263(a) disallows deductions for buildings and most tangible property improvements (i.e., betterments, adaptations, and restorations). Instead of deducting these costs immediately, taxpayers must capitalize §263(a) enhancements and recover these investments through depreciation.

Distinguishing between “ordinary and necessary” expenses and property improvements often proves challenging for accountants and tax professionals. For example, one could argue that replacing a window in a rental unit would constitute an ordinary and necessary business expense. Others, however, may consider that same expense an improvement to that rental unit.

The IRS attempted to provide guidance on the distinction between §§162(a) and 263(a) by consolidating case law and other administrative rulings.¹ To remove some of the ambiguity in the Code, the IRS also created certain safe harbors for taxpayers as part of these tangible property regulations.

The tangible property regulations went into effect for tax years beginning on or after January 1, 2014. Nearly 10 years after its adoption, the application of Treasury Decision (TD) 9636 is still a perplexing and laborious task. While these regulations provide more guidance and insight, they do not clarify every position. Facts-and-circumstances tests still require a reasonable application of the Code and the regulations to analyze a taxpayer’s unique situation.

Everyone who files a Schedule C, *Profit or Loss From Business*; Schedule F, *Profit or Loss From Farming*; or Schedule E, *Supplemental Income and Loss*, is subject to TD 9636. Consequently, the tangible property regulations have a far-reaching impact, necessitating taxpayers with businesses and farms to familiarize themselves with the concepts contained therein.

The tangible property regulations take the approach that taxpayers must capitalize all noninventory tangible property (i.e., depreciated on the taxpayer’s return) unless an exception applies. Exceptions include qualifying materials and supplies², as well as repairs and maintenance.³ These exceptions are not subject to depreciation and can be deducted on the taxpayer’s return. The deduction’s timing varies by item type and how the taxpayer treats the item for business purposes. In addition to exceptions, the final regulations allow taxpayers to deduct certain items that otherwise must be capitalized and to capitalize certain items that otherwise could be deducted through special elections and safe harbors.

¹. TD 9636, 2013-43 IRB 331.

². Treas. Reg. §1.162-3.

³. Treas. Reg. §1.162-4.

SCOPE OF TD 9636

The tangible property regulations focus on expense recognition, which is a broad area that involves numerous aspects of accounting concepts. There are 13 separate regulations in TD 9636 that encompass the following subjects.

- Materials and supplies (Treas. Reg. §1.162-3)
- Repairs (Treas. Reg. §1.162-4)
- Rentals (Treas. Reg. §1.162-11)
- Obsolescence of non-depreciable property (Treas. Reg. §1.165-2)
- Leased property (Treas. Reg. §1.167(a)-4)
- Accounting for depreciable property (applicability note modifying Treas. Reg. §1.167(a)-7)
- Retirements (applicability note modifying Treas. Reg. §1.167(a)-8)
- Accounting for modified accelerated cost recovery system (MACRS) property (Treas. Reg. §1.168(i)-7)
- Capital expenditures, in general (Treas. Reg. §1.263(a)-1)
- Amounts paid to acquire or produce tangible property (Treas. Reg. §1.263(a)-2)
- Amounts paid to improve tangible property (Treas. Reg. §1.263(a)-3)
- Election to deduct or capitalize certain expenses (Treas. Reg. §1.263(a)-6)

WARRANT FOR REVISITATION

While the tangible property regulations took effect nearly a decade ago, it may behoove taxpayers and practitioners to revisit the rules, nuances, and application of these regulations. Since the introduction of these regulations, the enactment of new tax laws and procedures have occurred, particularly the Tax Cuts and Jobs Act (TCJA). Among its changes, TCJA included the change to IRC §168(k) allowing taxpayers to expense purchased capital assets using 100% bonus depreciation instead of the prior 50%.⁴ Starting in 2023, this provision begins to phase-out, where taxpayers may only immediately expense 80% bonus depreciation. This change will result in taxpayers needing to more carefully assess whether capitalization of new purchases or expensing them provides the most benefit, as these will no longer result in the same amount of immediate deduction as it had before. Consequently, taxpayers and practitioners must familiarize themselves with the tangible property regulations to determine which methods apply to them and how to implement any necessary changes.

Additionally, a taxpayer's tax situation and business can change over time. Income from a business could change from year to year, prompting owners to evaluate whether expense recognition should be accelerated. One area that provides such flexibility is in the capitalization of expenditures. Tax planning around these expenses can help in adjusting the amount of expenses a taxpayer reports on their tax return. However, taxpayers and practitioners need to be aware of the rules and concepts behind this strategy, especially implementing a change in their method of accounting to coordinate these efforts, described in detail later in this chapter. As taxpayers' businesses change, or if practitioners obtain new clients, one should familiarize themselves with the tangible property regulations regularly to stay compliant in implementing new and different strategies.

⁴. *Tax Cuts and Jobs Act*, PL 115-97, §13201.

FUNDAMENTAL CONCEPTS

Examining fundamental principles in tangible property regulations is required to discuss the concepts of capitalization and repair. These regulations introduced new concepts into the theory of the U.S. tax system and are vital to understanding the nature of the changes contained therein for systematized and compliant tax return preparation.

UNIT OF PROPERTY⁵

Unit of property (UOP) is a critical concept in the tangible property regulations that clarifies whether a taxpayer may deduct an item or is required to capitalize it. The regulations define UOP as consisting of all the components of property that are **functionally interdependent**. Functional interdependence is achieved when the placing in service of one component is dependent on the placing in service of another component. For example, a vehicle engine is not in and of itself a UOP because it cannot function without a vehicle, and vice versa. On the other hand, a computer and printer can function independently from each other, so they are considered separate UOPs. The regulations distinguish between building property and tangible nonbuilding property (i.e., personal property and nonbuilding real property) in determining the UOP.

Building Property

An entire building structure (roof, walls, windows, floors, and ceiling) is one UOP. Each building system is a separate UOP. The regulations identify the following building systems considered separate UOPs from the building structure.

- Heating, ventilating, and cooling (HVAC) system
- Plumbing system
- Electrical system
- Escalator system
- Elevator system
- Fire protection and alarm system
- Security system
- Gas distribution system
- Other structural components identified in published guidance in the Federal Register or the Internal Revenue Bulletin

Property Other Than Buildings

Generally, all components of real or personal property that are functionally interdependent comprise a single UOP. Unlike an asset-by-asset determination for class life and recovery period, functional interdependence depends on **the taxpayer's use of the asset**.

Special rules apply to plant property, network assets, leased property other than buildings, and components placed in service in taxable years beginning before January 1, 2014.

⁵. TD 9636, 2013-43 IRB 331.

Plant Property.⁶ Plant property is functionally interdependent machinery or equipment, other than network assets (described later), used to perform an industrial process, such as manufacturing, generation, warehousing, distribution, automated materials handling in service industries, or similar activities. For plant property specifically used to perform an industrial process, the UOP is further divisible into smaller units comprised of each component or group of components that perform a discrete and major function or operation within the functionally interdependent machinery or equipment.

Network Assets.⁷ Network assets generally include assets that form an interconnected grid or web system. This category includes pipelines, railroad tracks, water and sewage lines, power transmission lines, and cable lines. The particular facts and circumstances or industry guidance from the Treasury Department and the IRS determine the UOP and the application of the improvement analysis.

Leased Property.⁸ For determination of the UOP, when a taxpayer is the lessee of leased property other than buildings, the same general rule, plant property rule, and network asset rule apply as they would otherwise. For taxpayers who lease buildings or portions of buildings, the UOP comprises the following.

- Each building and its structural components and systems
- The portion of each building subject to the taxpayer's lease and the portion of the structural components and systems that are part of the leased building

Example 1. Alice leases space for her consulting business on the third floor of an office building. The UOP for Alice's consulting business is the portion of the building she leases, including the structural components of her leased space.

Components Placed in Service in a Tax Year Beginning Before 2014.⁹ Consider situations where a taxpayer placed a component (or group of components) in service before 2014. Suppose those component(s) are now considered a UOP under the regulations and that the taxpayer properly treated the component(s) as being in a different MACRS class than the UOP. In that case, the taxpayer must treat those component(s) as a separate UOP. This practice also applies when the taxpayer properly depreciated the component using a different method than the UOP.

Special Rules Applicable to All Properties

Although there are certain exceptions, **a taxpayer generally must capitalize all related amounts paid to improve a UOP owned by the taxpayer.**¹⁰ This extends to amounts paid for more than one taxable year. Whether amounts are related to the same improvement depends on the facts and circumstances of the performed activities.¹¹

Certain Spare Parts. If the costs of rotatable spare parts, temporary spare parts, or standby emergency spare parts (discussed later) were capitalized and used as an improvement to a UOP, then for purposes of applying the preceding requirement to capitalize improvements to the UOP, the part is not a UOP separate from the UOP improved.¹²

⁶ Treas. Reg. §1.263(a)-3(e)(3)(ii).

⁷ Treas. Reg. §1.263(a)-3(e)(3)(iii).

⁸ Treas. Reg. §1.263(a)-3(e)(2)(v).

⁹ Treas. Reg. §1.263(a)-3(e)(5)(i).

¹⁰ Treas. Reg. §1.263(a)-3(d).

¹¹ Treas. Reg. §1.263(a)-3(g)(3).

¹² Treas. Reg. §1.263(a)-3(e)(4).

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Changes in Subsequent Year. There may be instances where depreciation of a UOP occurred under these regulations, but in later years either the taxpayer or the IRS determines that a portion of that UOP belongs in a different MACRS class or requires a different depreciation method. Treas. Reg. §1.263(a)-3(e)(5)(ii) provides clarity on these scenarios. If the taxpayer or the IRS changes the treatment of a UOP (or any portion thereof) that the taxpayer placed in service in a prior taxable year to a proper MACRS class or depreciation method, then the taxpayer must change the UOP determination for consistency with the change in treatment for depreciation purposes. Such a change could result from a cost segregation study or a change in the property's use.

Thus, if a taxpayer properly reclassifies a portion of a UOP to a different MACRS class, then the taxpayer should treat the reclassified portion of the property as a separate UOP. If, on the other hand, a taxpayer finds properties previously depreciated in different classes to be part of the same UOP, then the taxpayer must treat them uniformly as the same UOP.

Example 2. Todd purchased a building for his photography business in 2020 for \$240,000. He capitalized the \$40,000 costs of the electrical wiring for the building separately as 7-year property. After performing a cost segregation study of the building in 2023, Todd's accountant appropriately determined that the wiring in Todd's building was a structural component and needs to be depreciated as 39-year nonresidential real property. Consequently, Todd changes his method of accounting to address this difference in treatment. Todd needs to consider the wiring as part of the building's UOP.

Todd files Form 3115, *Application for Change in Accounting Method*, and computes the excess depreciation he claimed in 2020 and 2021 using the 7-year life instead of the correct 39-year life. Todd's original depreciation schedule showing the wiring of the building having a 7-year depreciable life follows.

Asset	Date in Service	Cost	Life	Convention ^a	Prior Depreciation	2022 Depreciation
Building	1/01/2020	\$200,000	39	MM S/L	\$10,043	\$ 5,128
Wiring	1/01/2020	40,000	7	HY 200DB	15,510	6,997
Total		\$240,000			\$25,553	\$12,125

^a MM S/L = midmonth straight-line, HY 200DB = half-year double-declining balance.

Todd's corrected depreciation schedule with the wiring having a 39-year depreciable life is as follows.

Asset	Date in Service	Cost	Life	Convention	Prior Depreciation	2022 Depreciation
Building	1/01/2020	\$200,000	39	MM S/L	\$10,043	\$5,128
Wiring	1/01/2020	40,000	39	MM S/L	2,009	1,026
Total		\$240,000			\$12,052	\$6,154

Todd must add this excess depreciation of \$13,501 (\$15,510 of prior 7-year depreciation – \$2,009 of corrected 39-year accumulated depreciation) to his income.

Note. For more information on depreciation methods and conventions, see the 2023 *University of Illinois Tax Workbook*, Chapter 7: Depreciation.

MATERIALS AND SUPPLIES

Treas. Reg. §1.162-3 clarifies what are considered materials and supplies that taxpayers may expense. Materials and supplies are any tangible property a taxpayer uses or consumes in their operations, are not inventory, and **meet at least one of the following criteria.**¹³

1. Is a component a taxpayer acquires to maintain, repair, or improve a unit of tangible property they own, lease, or service and **that they do not acquire as part of any single UOP**
2. Consists of fuel, lubricants, water, and similar items, reasonably expected for a taxpayer to consume in 12 months or less, beginning when used in their operations
3. Is a UOP that has an **economic useful life** of 12 months or less, beginning when a taxpayer uses or consumes the property in their operations
4. Is a UOP that has an acquisition cost or production cost (determined under IRC §263A) of \$200 or less or an amount provided in further guidance in the Federal Register or the Internal Revenue Bulletin
5. Is otherwise identified in published guidance in the Federal Register or the Internal Revenue Bulletin as materials and supplies for purposes of this regulation

Materials and Supplies Categories¹⁴

The regulations classify materials and supplies into the following three categories.

1. Incidental
2. Nonincidental
3. Rotable, temporary, or standby emergency spare parts

These categories determine when taxpayers can deduct the cost of materials and supplies on their returns.

Incidental Materials and Supplies. Incidental materials and supplies are items a taxpayer carries on hand that they exclude from inventory and do not keep records regarding their consumption. Examples of incidental supplies include pens, calculators, coffee pots, and paper towels. Amounts the taxpayer pays to purchase or produce incidental materials and supplies are deductible in the tax year paid (or the year incurred for accrual-basis taxpayers).

Example 3. Sam owns and operates a grocery store and purchases hand sanitizer for customer and employee use. Sam does not keep records of its consumption. Therefore, the hand sanitizer is incidental in Sam's case. Sam is a cash-basis taxpayer, so he deducts the cost of hand sanitizer in the year he purchases it.

Nonincidental Materials and Supplies. Nonincidental materials and supplies (NIMS) are materials and supplies that do not fall into the incidental category. Examples of NIMS include disposable cups at a coffee shop where the owner counts cups monthly to eliminate shrinkage, and shaving cream at a barber shop where the barber keeps track of the amount of product used weekly. A taxpayer generally deducts the cost of NIMS when they place these items in service for business use or when consumed in operations.

Example 4. Molly uses catering trays to transport food to customers of her catering business. She regularly keeps track of how many trays she has on hand to ensure she has enough for customer orders throughout a given month. The catering trays are nonincidental because Molly keeps track of the number of trays that she has. Molly is permitted to deduct the cost of the trays in the year she places them in service.

¹³ Treas. Reg. §1.162-3(c)(1).

¹⁴ Treas. Reg. §1.162-3.

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Small Business Taxpayer Exemption.¹⁵ Taxpayers with gross receipts less than \$10 million are not required to maintain an inventory when the production, purchase, or sale of merchandise is an income-producing factor. Small business taxpayers can either treat inventory as a NIMS, follow the inventory rules stated in the taxpayer's applicable financial statement (AFS) (discussed later), or use their books and records prepared in accordance with their accounting procedures if they do not have an AFS.

Taxpayers who treat inventory as NIMS still treat the items as inventory. The costs are recovered through cost of goods sold in the later of either the year the inventory was provided to the customer or when the costs are paid or incurred. **The costs cannot be immediately written off.**

Example 5. Larry has a retail furniture store whose average annual gross receipts are \$5 million. His inventory purchases each year vary between \$2 million and \$3 million. Although Larry is a qualifying small business and is not required to use IRC §471 to track his inventory, he chooses to use the NIMS method to deduct his cost of goods sold.

Rotable, Temporary, or Standby Emergency Spare Parts. Rotable and temporary parts are components used to improve, repair, or maintain a UOP owned, leased, or serviced by a taxpayer. A taxpayer cannot acquire these components as part of the UOP purchase (e.g., an engine salvaged from another vehicle a taxpayer owns is not a spare part because the other vehicle was the UOP).

To qualify as a **rotable** spare part, the item must be:

- Acquired for installation on a UOP,
- Removable from that UOP,
- Repairable or improvable, and
- Either reinstalled on a UOP or stored for later installation.

Temporary spare parts are parts for use only until a new or repaired part is available for installation. Such parts are subsequently removed and stored for later use.

A taxpayer generally acquires **standby emergency** spare parts to prepare for crisis situations when a key piece of equipment malfunctions. Standby emergency spare parts are materials and supplies if they **meet all the following criteria.**

1. Acquired when a particular piece of machinery or equipment is acquired
2. Set aside to minimize operational downtime due to equipment failure or emergency
3. Readily available for use (located at or near the equipment site)
4. Directly related to the machinery or the equipment intended for repair
5. Normally expensive
6. Must be special ordered (otherwise not readily available)
7. Not subject to periodic replacement
8. Not interchangeable in another piece of machinery or equipment
9. Not acquired in large quantity
10. Not repaired and reused

¹⁵ IRC §471; Treas. Reg. §1.471-1.

Unless an exception applies, the regulations deem that a taxpayer first uses a rotatable or temporary spare part in the tax year in which the taxpayer **disposes** of the part. This practice may delay the expense deduction of these parts for quite some time. Applicable exceptions to this rule include the following.

- An election to capitalize the expense for the qualified parts
- Using an optional method of accounting for **all** rotatable and temporary spare parts
- An election to use a de minimis safe harbor

Optional Method.¹⁶ When using the optional method of accounting for rotatable and temporary spare parts, a taxpayer must deduct the cost of these parts when first installed. However, upon removal of the part, the taxpayer must add the fair market value (FMV) of the part to gross income. The taxpayer would then include the FMV and the removal costs in the part's basis. The basis would also include any subsequent repairs, maintenance, or improvement costs for the part. The taxpayer cannot deduct these amounts until they dispose of or reinstall the part.

Election to Capitalize Cost of Qualified Parts.¹⁷ Taxpayers may elect to capitalize and depreciate costs for rotatable, temporary, or standby emergency spare parts used to repair, maintain, or improve a UOP owned, leased, or serviced by the taxpayer. This election changes the tax treatment of these parts to capital assets; therefore, they are no longer considered materials or supplies. By electing to capitalize these costs, the taxpayer may be able to start recovering the expenses of acquiring spare parts sooner than waiting for the part's disposition.

Ineligible Costs. Taxpayers **cannot elect** to capitalize the cost of rotatable, temporary, or standby emergency spare parts under the following circumstances.

1. The part is intended for use as a component of a UOP that:
 - Has an economic useful life of 12 months or less, beginning with the taxpayer's use or consumption,
 - The part costs \$200 or less, or
 - The part is identified in published guidance in the Federal Register or the Internal Revenue Bulletin.
2. The taxpayer cannot or has not elected to capitalize the property that the part would fix.
3. The taxpayer uses the optional method of accounting for rotatable and temporary spare parts.

Manner of Election. The taxpayer must make the election to capitalize rotatable, temporary, or standby emergency spare parts on a timely filed original federal tax return (including extensions) for the tax year the asset is placed in service for determining depreciation. To make the election, the taxpayer capitalizes the cost of the part in the year of acquisition. However, the taxpayer does not begin to recover the costs through depreciation until they place the part in service. **No separate election statement is necessary.** The election is entity-level for S corporations and partnerships; partners or shareholders do not make the election individually. Taxpayers can make the election for each part. Revocation of the election requires the IRS's consent.

Example 6. Terry Stevens' printing and copier services business uses multiple printing machines. One of the high-end printers uses a laser that must be special-ordered and can sometimes take weeks to ship out. To ensure that the printer is not down for long periods of time if its laser requires replacement, Terry purchases a spare laser in 2022. The spare laser qualifies as a temporary spare part. Because the spare laser is a material or supply cost, Terry does not capitalize it. However, Terry must wait to deduct the cost of the spare part until he **disposes** of it.

Because the part is relatively expensive, and he does not know when he will need to use it and how long it will take until he ultimately disposes of it, Terry elects to capitalize the expense. He lists the asset on his 2022 depreciation schedule but delays recovery of his costs through depreciation until the year he places the part in service.

¹⁶ Treas. Reg. §1.162-3(c)(2).

¹⁷ Treas. Reg. §1.162-3(d).

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Application to Farmers¹⁸

A farmer who operates a farm for profit is entitled to deduct from gross income as necessary expenses all amounts actually expended in conducting the farming business. The expenditure (**not the consumption**) of materials and supplies serves as the basis for the deduction and remains available to all farmers.

Observation. Treas. Reg. §1.162-12(a) specifically applies to farmers. It is an exception from the more general provisions of Treas. Reg. §1.162-3(a), which otherwise defers the deductibility of NIMS until the year consumed. For this reason, cash-method farmers may report their financial position and results of operations using generally accepted accounting principles (GAAP) based financial statements without the requirement of deferring tax deductions for prepaid expenses if the expenses are deferred on the financial statement.

Tires¹⁹

Non-Agricultural Tires. For non-agricultural trucks and tractors, the IRS provides a safe harbor method of accounting for the cost of original and replacement tires for qualifying vehicles. The tangible property regulations did not change the safe harbor. Under the safe harbor, a qualifying vehicle's tires are treated as part of the vehicle and not as separate assets. A qualifying vehicle is one for which §168 determines depreciation and includes converter dollies and vehicles described in asset class 00.241 (light general-purpose trucks), 00.242 (heavy general-purpose trucks), 00.26 (tractor units for over-the-road use) and 00.27 (trailers and trailer-mounted containers) of Rev. Proc. 87-56.²⁰

Under the safe harbor, a taxpayer must capitalize the cost of the original tires of a qualifying vehicle and depreciate them under §168 using the same depreciation method, recovery period, and convention applicable to the vehicle on which the taxpayer first installed the tires. The taxpayer must also treat the qualifying vehicle's original tires as disposed of when disposing of the vehicle on which the taxpayer first installed the tires. Additionally, the taxpayer must deduct the cost of the replacement tires of the qualifying vehicle as an expense in the tax year the taxpayer installs the replacement tires on the vehicle.

Example 7. Jack placed a light truck in service in 2018 and replaced the tires in 2020 and 2022. Under the safe harbor, Jack depreciates the original tires as part of the truck over the truck's 5-year MACRS recovery period (even though he replaced them in 2020) but can expense the cost of the replacement tires in 2020 and 2022.

Agricultural Tires. Rev. Proc. 2002-27 applies to "qualifying vehicles," which includes those in asset classes 00.241, 00.242, 00.26 and 00.27. As mentioned previously, these are light general-purpose trucks (i.e., pickups), heavy general-purpose trucks, truck tractors, and truck trailers. These asset classes do not include farm tractors.

Example 8. Ricky bought a used tractor in 2019 and depreciated the tractor's cost (including the tires) over seven years using the 200% declining balance method for farm equipment. In 2022, Ricky paid \$20,000 to replace all the tires on his tractor. Because Ricky's tractor is property other than a building, the general rule in Treas. Reg. §1.263(a)-3(e)(3)(i) determines the initial UOP for the tractor. It is composed of all the functionally interdependent components. Under this rule, Ricky must treat the tractor, including its tires, as a single UOP. This treatment results from the tractor and tires having functional interdependence (that is, the placing in service of the tires depends upon the placing in service of the tractor).²¹ The replacement tires do not improve the tractor (they do not adapt the tractor to a new or different use, are not a betterment, and are not a restoration). Therefore, Ricky can deduct the cost of the tires as a business expense under §162 on his 2022 income tax return.

¹⁸ Treas. Reg. §1.162-12(a).

¹⁹ Rev. Proc. 2002-27, 2002-1 CB 802.

²⁰ Rev. Proc. 87-56, 1987-2 CB 674.

²¹ Treas. Reg. §1.263(a)-3(e)(6), example 16.

Further bolstering the point that the treatment of farm tires is not as separate components of a UOP, Treas. Reg. §1.263(a)-3(e)(5) states:

*Notwithstanding the unit of property determination under paragraph (e)(3) of this section, a component (or a group of components) of a unit property must be treated as a separate unit of property **if**, [emphasis added] at the time the unit of property is initially placed in service by the taxpayer, the taxpayer has properly treated the component as being within a different class of property under section 168(e) (MACRS classes) than the class of the unit of property of which the component is a part, or the taxpayer has properly depreciated the component using a different depreciation method than the depreciation method of the unit of property of which the component is a part.*

The key word of that regulation is “if.” The concept of the regulation does not apply in agriculture to farm tractor (or combine, etc.) tires. Farm tractor tires do not wear out in one year, and the easier approach is to treat them as part of the asset’s cost. Because taxpayers do not depreciate farm tractor tires separately, the component rule of the regulation does not apply.

Summary. The standard still holds that if the asset wears out (because truck tires are viewed as separate assets) within 12 months, the taxpayer would expense them. This standard is beneficial to the trucking industry because it allows the benefit of separately handling tires. Additionally, only over-the-road trucks and trailers are eligible equipment for purposes of the safe harbor of Rev. Proc. 2002-27. Rev. Proc. 2002-27 does not apply to all tires used in any business; it does not apply to farm tractor tires.

Tractor tires are always deductible when a taxpayer purchases them to replace tires on an existing tractor. Therefore, the taxpayer does not separately identify and depreciate the tires, instead treating them as part of the UOP — the tractor. The taxpayer treats the replaced tires as repairs. However, these costs are not deductible when the taxpayer buys a tractor. Although heavy trucks also see use in agriculture, they are commonly depreciable as a unit (including their tires). Taxpayers do not treat agricultural heavy truck tires separately as a 7-year farm equipment asset.

APPLICABLE FINANCIAL STATEMENT²²

Taxpayers with an AFS are subject to different qualification requirements than non-AFS taxpayers regarding certain tangible property classifications and thresholds described later in this chapter. AFS fall into the following three categories (listed in the order of priority from highest to lowest).

1. A financial statement having a filing requirement with the Securities and Exchange Commission (SEC) (the 10-K or the Annual Statement to Shareholders)
2. A certified audited financial statement that is accompanied by the report of an independent CPA (or, in the case of a foreign entity, by the report of a similarly qualified independent professional) for the use of one of the following:
 - Credit purposes
 - Reporting to shareholders, partners, or similar persons
 - Any other substantial **nontax** purpose
3. A financial statement (other than a tax return) required by the federal or a state government/agency, excluding the SEC or the IRS

Note. Whether a taxpayer has an AFS is important because it determines the taxpayer’s economic useful life of an asset and affects the taxpayer’s de minimis threshold. However, acceptance of (and reliance on) the taxpayer’s financial statement by an outside party or agency (such as a bank or government agency) is necessary for a valid AFS.

²² Treas. Regs. §§1.162-3(c)(4)(iii)(A)-(C).

ECONOMIC USEFUL LIFE

The regulations define economic useful life as “the period over which the property may reasonably be expected to be useful to the taxpayer in its trade or business or for the production of income, as applicable.”²³

A taxpayer should reference previous experience with similar assets to determine the expected useful life of an asset, considering any unique facts and circumstances related to the property but disregarding salvage value. Factors of consideration include the item’s wear and tear or natural decay or decline, industry-specific developments or technological changes, the taxpayer’s business climate, and the taxpayer’s repair or replacement policy.²⁴

When taxpayers do not have sufficient experience with an asset to determine its economic useful life, they can use the industry’s general experience until their own experience allows more informed judgment. A taxpayer can adjust an asset’s estimated remaining useful life if the asset’s condition causes a significant change in such life, but there must be a “clear and convincing” basis for any redetermination.²⁵

A taxpayer determines an asset’s economic useful life differently depending on whether they have an AFS. Taxpayers with an AFS retain the useful life initially used to depreciate the item on the AFS. If a taxpayer expensed an item on the AFS that would otherwise be subject to depreciation, the taxpayer determines that asset’s useful life as described in the preceding paragraphs.²⁶

Example 9. As the owner-manager of a small restaurant, Wilma Kendricks uses the camera feature on her smart phone to take photos of her lunch specials, which she posts daily on social media. Due to the ever-increasing number of social media apps, she often runs out of storage space on her phone. She generally replaces her phone with the latest model every 18 months at a cost of approximately \$300 after trade-in. Wilma does not have an AFS.

Wilma’s phone would not fall into the material or supply category because its economic useful life is greater than 12 months in Wilma’s hands. The phone costs more than \$200, and it is not a consumable item. Furthermore, Wilma does not use the phone to improve, repair, or maintain her property. Wilma must capitalize the expense for her replacement phone and recover its cost over time.

Example 10. Mike Anders also uses a smart phone in his insurance business to take pictures of claims and to communicate with his clients. Because he has a personal history of dropping his phone and cracking its screen, he has a policy of replacing his phone annually at a cost of approximately \$375. Mike’s phone is a material or supply because the phone’s economic useful life in Mike’s hands is 12 months or less. He can deduct the expense for a new phone.

SAFE HARBOR ELECTIONS

Instead of analyzing expenditures to determine whether a taxpayer must capitalize a given cost or can expense it, the regulations allow the following alternatives.

1. Routine maintenance safe harbor
2. Safe harbor for buildings for small taxpayers
3. De minimis safe harbor

²³ Treas. Reg. §1.162-3(c)(4)(i).

²⁴ Treas. Reg. §1.167(a)-1(b).

²⁵ Ibid.

²⁶ Treas. Reg. §1.162-3(c)(4)(ii).

Routine Maintenance Safe Harbor²⁷

While Treas. Reg. §1.263(a)-3 provides numerous examples for illustration, it often is still difficult to discern a repair from an improvement. The regulations guide taxpayers through these gray areas by introducing the routine maintenance safe harbor.

The routine maintenance safe harbor allows taxpayers to deduct work performed that meets **all** the following parameters.

1. The taxpayer uses the property in a trade or business.
2. As a result of the business use of the property, the taxpayer expects to perform maintenance on a **recurring** basis.
3. The recurring maintenance will keep the property in its **ordinarily efficient operating condition**.
4. At the time the property is placed in service, the taxpayer **reasonably expects** to perform the recurring maintenance:
 - More than once over the next 10 years for building property and building systems, or
 - More than once during the alternative depreciation system class life of the nonbuilding property.

If a taxpayer does not actually perform the maintenance work more than once in the prescribed time allotments, it does not invalidate this safe harbor. The taxpayer can rely on the following factors in making a reasoned prediction.

- The recurring nature of the activity
- Industry practice
- Manufacturer recommendations
- The taxpayer's experience with similar or identical property

Routine maintenance performed on rotatable and temporary parts generally qualifies for this safe harbor unless the taxpayer uses the optional method of accounting for these parts.

Routine maintenance does not include the following amounts.

1. Betterment to a UOP
2. Replacement of a UOP's component for which a taxpayer properly deducted (other than a casualty loss)
3. Replacement of a UOP's component that a taxpayer properly adjusted basis in realizing gain or loss resulting from the sale or exchange of the component
4. Restoration of damage to a UOP requiring a taxpayer to take a basis adjustment resulting from a casualty loss or relating to a casualty event subject to the limits identified in Treas. Reg. §1.263(a)-3(k)(4)
5. Return of a UOP to its ordinarily efficient operating condition, if the property has deteriorated to a state of disrepair and is no longer functional for its intended use
6. Adaptation of a UOP to a new or different use
7. Repairs, maintenance, or improvement of network assets
8. Repairs, maintenance, or improvement of rotatable and temporary spare parts to which a taxpayer applies the optional method of accounting for rotatable and temporary spare parts

²⁷ Treas. Reg. §1.263(a)-3(i).

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Example 11. Use the same facts as **Example 6**. Terry Stevens purchased a used copier machine for his copier and printing services business in 2022. While Terry prefers to purchase new machinery and equipment, this particular copier is specialized and expensive. Terry hired a service company to perform annual preventative maintenance on the copier machine to ensure it stays in efficient working condition. Shortly after the first time the company serviced the machine, it went out of business. Terry has yet to find a replacement service company and is concerned about finding one in his area. Because he reasonably expects to perform annual maintenance on the copier to keep it in its ordinarily efficient operating condition, Terry can still use the routine maintenance safe harbor for his service costs in 2022.

The safe harbor for routine maintenance is **not an election**. The IRS intended prior law to serve as the basis for these regulations.²⁸ A taxpayer who complied with the previous regulations is not required to take any action to be protected by this safe harbor. However, a taxpayer who was not compliant or who wants to change their accounting method to use this safe harbor should file Form 3115. A common scenario for applying the safe harbor includes situations in which the taxpayer changes to the routine maintenance safe harbor or already applies it in the regular course of business.

Safe Harbor Election for Buildings for Small Taxpayers²⁹

The final regulations provide another safe harbor that allows qualified small taxpayers to deduct certain costs for **eligible building property**. Under the small taxpayer safe harbor, taxpayers may deduct eligible expenditures in the year paid. Qualified small taxpayers must have **average annual gross receipts of \$10 million or less for the three preceding tax years**.

The term “eligible building property” applies to each unit of building property with an **unadjusted basis of \$1 million or less**. A taxpayer who leases building property determines the unadjusted basis of the leased property by multiplying the undiscounted rent paid or expected to be paid by the taxpayer for the entire lease term. This term should include renewal periods if the taxpayer reasonably expects renewal.

Qualified Expenditures. Qualified expenditures under this safe harbor include repairs, maintenance, improvements, and similar activities performed on each eligible building, limited to the **lesser** of:

- 2% of the building’s unadjusted basis, or
- \$10,000.

Qualified expenditures otherwise would not be capitalized under the de minimis safe harbor election or the routine maintenance safe harbor for buildings.

The limitation on expenditures applies individually to buildings (i.e., if a taxpayer owns multiple buildings, the limits apply separately to each building). If the expenses for a particular building exceed the limitation threshold, the taxpayer cannot use the small taxpayer safe harbor for that building. The taxpayer then must determine the UOP and apply the betterment, adaptation, or restoration (BAR) tests (discussed later) to the expenditures. The taxpayer may use the safe harbor for routine maintenance and the de minimis safe harbor election for expenses that do not qualify for the small taxpayer safe harbor.

²⁸ *Tangible Property Regulations — Frequently Asked Questions*. Nov. 10, 2022. IRS. [www.irs.gov/businesses/small-businesses-self-employed/tangible-property-final-regulations] Accessed on Feb. 8, 2023.

²⁹ Treas. Reg. §1.263(a)-3(h).

De Minimis Safe Harbor Election³⁰

Under the tangible property regulations, a taxpayer may elect to apply a **de minimis safe harbor** to amounts **paid to acquire or produce tangible property, including materials and supplies**. This safe harbor allows the taxpayer to deduct small-dollar expenditures without analyzing each purchase to determine whether to capitalize them.

Materials and Supplies

	Election	Who May Elect
Parts used in repairs and maintenance	None	
Useful life of (or consumed in) less than 12 months	None	
Individual items costing \$200 or less	None	
Individual items costing \$2,500 or less	Annual de minimis safe harbor election	All taxpayers
Individual items costing \$5,000 or less	Annual de minimis safe harbor election	Only taxpayers issuing an AFS

The choice to use the de minimis safe harbor is an **annual election** which does not constitute a change in accounting method. Therefore, when the taxpayer decides to use (or not use) the de minimis safe harbor for any tax year, they are not required to file Form 3115.

Generally, the tangible property regulations do **not** change the rules for deducting materials and supplies. The general rules define materials and supplies as tangible, noninventory property used and consumed in the taxpayer's operations. These regulations indicate that costs relating to property in any of the following categories qualify as materials or supplies.

Category	Description of Costs
Acquired components	Costs of components acquired to maintain, repair, or improve tangible property owned, leased, or serviced by the taxpayer that are not acquired as part of a larger item of tangible property
Consumables	Costs of fuel, lubricants, water, and similar items that are reasonably expected to be consumed in 12 months or less, beginning when used in operations
12-month property	Costs of tangible property that has an economic useful life of 12 months or less, beginning when the property is used or consumed in operations
\$200 property	Costs of tangible property that has an acquisition cost or production cost of \$200 or less

³⁰ *Tangible Property Regulations — Frequently Asked Questions*. Nov. 10, 2022. IRS. [www.irs.gov/businesses/small-businesses-self-employed/tangible-property-final-regulations] Accessed on Feb. 8, 2023.

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The de minimis safe harbor election is an administrative convenience that permits taxpayers to elect the deduction of small-dollar expenditures that otherwise require capitalization under the general rules. Under the tangible property regulations, a taxpayer may elect to apply the de minimis safe harbor to these expenditures if they qualify. The qualifications depend on whether the taxpayer has an applicable AFS. The following table summarizes these qualifications for taxpayers with and without an AFS.

AFS Taxpayers ³¹	Non-AFS Taxpayers ³²
The taxpayer must have written accounting procedures at the beginning of the tax year that, for nontax purposes, treat as an expense: • Amounts costing less than a specified amount, or • Amounts paid for property with an economic useful life of 12 months or less.	The taxpayer must have accounting procedures at the beginning of the tax year that, for nontax purposes, treat as an expense: • Amounts costing less than a specified amount, or • Amounts paid for property with an economic useful life of 12 months or less.
The AFS must reflect the deduction of costs as outlined in the written accounting procedures.	Books and records must reflect the deduction of costs as outlined in the accounting procedures.
The amounts of the items expensed under the written accounting policy do not exceed \$5,000 per invoice (or per item as substantiated by an invoice).	The amounts of the items expensed under the accounting policy do not exceed \$2,500 per invoice (or per item as substantiated by an invoice).

Note. Non-AFS taxpayers are not required to have their accounting procedures **written**. However, to deduct the costs of materials and supplies under this safe harbor, treating the costs as current expenses must be part of a consistent accounting policy or procedure that exists at the beginning of the tax year.³³ Even if an expenditure meets the conditions allowing immediate expense under these rules, the cost might be subject to capitalization under the §263A uniform capitalization rules.³⁴

The intention behind the \$5,000 and \$2,500 threshold amounts **does not represent ceilings on the amounts taxpayers can deduct as ordinary business expenses**. Using the de minimis election does not mean that the taxpayer must capitalize all expenditures over the threshold amount that applies to them.

³¹. Treas. Reg. §1.263(a)-1(f)(1)(i).

³². Treas. Reg. §1.263(a)-1(f)(1)(ii).

³³. *Tangible Property Regulations — Frequently Asked Questions*. Nov. 10, 2022. IRS. [www.irs.gov/businesses/small-businesses-self-employed/tangible-property-final-regulations] Accessed on Feb. 8, 2023.

³⁴. Treas. Reg. §1.263(a)-1(f)(1).

Eligibility Requirements for De Minimis Safe Harbor. Taxpayers electing the de minimis safe harbor must apply the threshold amount to all tangible property placed in service during the tax year and to material and supply costs for which an exception does not apply.

Although a written policy is not required, an example of a financial accounting policy follows.

[Company Name] Financial Accounting Policy: Capitalization

The purpose of this policy is to create an accurate assessment of the company's financial position. The following capitalization policy will be followed in accounting for asset acquisitions.

Assets that meet both of the following requirements will be deemed "capital assets" and must be capitalized and depreciated for bookkeeping purposes:

1. A unit of property that has an economic useful life to the company in excess of 12 months, and
2. A unit of property that was acquired or produced for \$____ or more.

All assets acquired for a cost less than \$____ must be expensed for bookkeeping purposes.

All assets with an economic useful life to the company of 12 months or less must be expensed for bookkeeping purposes, regardless of cost.

This policy is intended to satisfy the provisions of the de minimis safe harbor election of Treasury Regulation §1.263(a)-1(f).

Setting the dollar threshold at the \$2,500 maximum amount may sound tempting. However, examining the taxpayer's unique facts and circumstances before setting the threshold limit is prudent. The taxpayer's nontax books and records **must reflect the same treatment** that the taxpayer elects on their tax return.

Example 12. Joe Donaldson plans to sell his used book store and retire soon. Accordingly, he opens his financials to prospective buyers. To show as much income as possible, Joe adopts a \$500 threshold for capitalization for 2022. This way, he is protected from a challenge when deducting low-cost improvements, but his books reflect more income and make his business appear more attractive to prospective buyers.

Electing the De Minimis Safe Harbor. To use the safe harbor, the taxpayer attaches a statement titled "Section 1.263(a)-1(f) De Minimis Safe Harbor Election" to the timely filed original federal tax return (including extensions) for the tax year in which they paid de minimis amounts. The statement includes the taxpayer's name, address, and taxpayer identification number (TIN), as well as a declaratory statement that the taxpayer is making the de minimis safe harbor election.

Example 13. Use the same facts as **Example 6**. Terry Stevens operates his printing and copying services business as a sole proprietorship. In 2022, he purchases a printer for \$360. Terry does not have an AFS. The printer does not meet the definition of a material or supply under the general rules. Therefore, Terry must capitalize and depreciate the printer unless he makes the de minimis safe harbor election for 2022 or makes an election under IRC §179. Terry attaches the following statement to his 2022 return.

Terry Stevens

TIN: 123-45-6789

Address: 23 Main St., Boston, MA 02108

Section 1.263(a)-1(f) De Minimis Safe Harbor Election

The taxpayer elects to make the de minimis safe harbor election under Regulation 1.263(a)-1(f).

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Example 14. Use the same facts as **Example 13**, except the printer costs \$150. Terry does not need to make the safe harbor election because the printer costs under \$200. Therefore, it qualifies as a material or supply under the general rules.

The intention of the safe harbor is not to prevent taxpayers from reaching an agreement with IRS examiners to use a larger amount. It may be prudent to elect the \$500 amount even if the taxpayer uses a larger amount. The taxpayer does not capitalize amounts they deduct under the de minimis rule and does not treat them as a material or supply. Instead, the taxpayer treats these amounts as “small equipment” and tracks them separately on their books and records.

Note. The sale of items for which a taxpayer elected the de minimis safe harbor is covered later in this chapter.

Safe Harbor Election to Capitalize Maintenance Costs³⁵

The tangible property regulations allow taxpayers to elect the capitalization and depreciation of repair and maintenance costs as qualified improvements if both the following occur.

1. The taxpayer incurs the costs in carrying on a trade or business.
2. The taxpayer treats the amounts as capital expenditures on their books and records regularly used for computing income.

This election reduces administrative burdens on taxpayers by permitting their tax treatments to match the capitalization policies they use for books and records. Taxpayers and their practitioners can also use the election as a tax planning tool.

Taxpayers electing to capitalize repair and maintenance costs may still apply the safe harbors (de minimis, small taxpayers, and routine maintenance) to repair and maintenance costs that taxpayers do not treat as capital expenditures on their books and records.

Taxpayers making this election must apply the election to **all** repair and maintenance amounts that they treat as capital expenditures on their books and records for that tax year. Depreciation on these costs begins when the taxpayer places the deemed improvements in service.

The cost of repairing or maintaining rotatable or temporary spare parts is **not** eligible for this election if the taxpayer uses the optional method of accounting for these parts.

To make this annual, irrevocable election, the taxpayer must attach a statement to their timely filed original federal tax return (including extensions) for the tax year in which they placed the improvement in service. The statement must include the following information.

- Title: “Section 1.263(a)-3(n) Election”
- Taxpayer’s name
- Taxpayer’s address
- TIN
- A statement that the election to capitalize repairs and maintenance costs is being made under §1.263(a)-3(n)

Elections for S corporations and partnerships are made at the entity level, not by individual shareholders or partners.

³⁵ Treas. Reg. §1.263(a)-3(n).

Partial Disposition Election

Generally, if a taxpayer replaces a portion of an asset with a capitalized improvement, the improvement cost is added to the depreciation schedule. Moreover, **any remaining basis allocable to the portion of the replaced asset** remains on the depreciation schedule.

Example 15. Susan owns a commercial building, which she purchased in 2017. In 2022, she replaced one of two air conditioners. Under the facts and circumstances analysis, replacing the air conditioner is considered a restoration of a major portion of a building system. Susan must capitalize the expenditure.

Susan adds the cost of the new air conditioner to her depreciable building property. Any remaining basis attributable to the replaced air conditioner continues to be included in the basis of the building. Susan does not adjust the basis or accumulated depreciation of the building after the air conditioner replacement.

Under the regulations,³⁶ certain events automatically qualify as partial dispositions based on the nature of the events. In other situations, the taxpayer may **elect** to treat a portion of an asset as having been disposed of when a taxpayer capitalizes the replacement for that portion under the same asset class. The taxpayer must make the election on a **timely filed (including extensions) original return** for the year of the disposition. **Generally, a taxpayer makes the election by reporting the gain, loss, or other deduction related to the disposition and properly capitalizing the improvement.**

Note. This election may be particularly beneficial for owners of real estate. Such owners may not expense replacement costs incurred because the tangible property regulations may require capitalization of those costs. However, this partial disposition election may allow owners to deduct the amount of the adjusted basis remaining in a replaced asset.

Example 16. Use the same facts as **Example 15**. Susan identified the portion of the original purchase price of the building that applied to the replaced air conditioner. She separates that cost and the accumulated depreciation allocable to that cost from her adjusted basis in the building. Susan takes the adjusted basis of the old air conditioner as a loss on her original 2022 return.

Susan adds the cost of the new unit to her depreciable assets using the same class life as the original unit. By treating the disposition and replacement consistently with the election, Susan has effectively made the partial disposition election for that asset for 2022.

Mandatory Imposition of Partial Disposition Rule.³⁷ A taxpayer generally may elect to claim a disposition of a portion of any type of MACRS property. However, there are cases when the partial disposition rule is **mandatory**, as in the following situations.

- A partial disposition resulting from a casualty event
- A partial disposition of an asset for which gain (determined without regard to depreciation recapture) is not recognized in whole or in part under a like-kind exchange or eminent domain process
- The transfer of a portion of an asset in a “step-in-the-shoes” transaction
- The sale of a portion of an asset

³⁶ Treas. Reg. §1.168(i)-8.

³⁷ Ibid.

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Planning Considerations Regarding the Partial Disposition Election. Making the partial disposition election provides an immediate tax deduction for the portion of the basis allocable to the retired asset. However, practitioners should consider the possible effects of the election if the sale of the retired asset occurs in a subsequent year.

1. The gain from the sale can be higher than it would have been without the election. However, the portion of the gain attributable to depreciation will be lower. Thus, a portion of the gain **might** shift from higher ordinary rates to lower capital gain rates.
2. The entire capital gain may be subject to the net investment income tax, depending on the taxpayer's income level.
3. The gain may increase the taxpayer's adjusted gross income (AGI) to levels that subject the taxpayer to phase-outs of various deductions and credits. Common tax provisions subject to phase-outs include education incentives, personal exemptions, itemized deductions, and individual retirement arrangement (IRA) deductions.
4. Although the tax rate for capital gains is the same for alternative minimum tax (AMT) and regular tax purposes, the tax rate for ordinary income is not. Both the ordinary income portion of the gain and the taxpayer's other income may be subject to the AMT rates and phase-outs.
5. The loss on the disposition is subject to recapture under IRC §1231 for five tax years after the election of the partial disposition treatment. The term **recapture** for this purpose refers to the recharacterization of §1231 gains as ordinary income rather than long-term capital gains.

Gain or Loss on Partial Dispositions.³⁸ Except in situations involving the demolition of a structure,³⁹ the following rules apply when a taxpayer disposes of an asset during a tax year. These general rules also apply to partial dispositions.

1. If a taxpayer disposes of an asset by sale, exchange, or involuntary conversion, the taxpayer must recognize the gain or loss.
2. If a taxpayer disposes of an asset by physical abandonment, the taxpayer must recognize the loss. The amount of loss is the adjusted depreciable basis⁴⁰ of the asset at the time of the abandonment (accounting for the applicable convention). However, if the abandoned asset is subject to **nonrecourse** indebtedness, it may be necessary to recognize a gain on the disposition. For a taxpayer to recognize a loss from physical abandonment, they must intend to discard the asset **irrevocably** (so that the taxpayer will neither use the asset again nor retrieve it for sale, exchange, or other disposition).
3. A limit to the amount of loss may exist if a taxpayer disposes of an asset other than by sale, exchange, involuntary conversion, physical abandonment, or conversion to personal use. Examples of this type of disposition include transferring the asset to a supplies or scrap account. In this situation, the taxpayer recognizes no gain. The allowed loss is limited to the amount, if any, by which the adjusted depreciable basis exceeds the asset's FMV at the time of the disposition.

Basis of the Disposed Portion of the Asset.⁴¹ In calculating gain or loss on a partial disposition, the adjusted basis of the asset's disposed portion is its adjusted depreciable basis at the time of its disposal, as determined under the applicable convention for the asset. If determining the unadjusted depreciable basis⁴² of the disposed portion of the asset is impracticable based on the taxpayer's records, the taxpayer may use any reasonable method to determine the unadjusted depreciable basis of the disposed portion of the asset.

³⁸ Treas. Reg. §1.168(i)-8(e).

³⁹ See IRC §280B and Treas. Reg. §1.280B-1.

⁴⁰ As defined in Treas. Reg. §1.168(b)-1(a)(4).

⁴¹ Treas. Reg. §1.168(i)-8(f).

⁴² As defined in Treas. Reg. §1.168(b)-1(a)(3).

Suppose a taxpayer disposes of more than one portion of the same asset. In that case, **the reasonable method used by the taxpayer must consistently apply** to all portions of the same asset to determine the unadjusted depreciable basis of each disposed-of portion.

Identification of the Disposed Portion of the Asset.⁴³ Generally, the taxpayer must identify the specific asset disposed and the tax year in which they placed the asset in service. A taxpayer may account for the asset in a multiple-asset account (or pool), but it may be impracticable to determine the tax year in which they placed the asset in service based on the taxpayer's records. In that event, the taxpayer must identify the asset using any applicable method listed in the following table.

Method	Description
First-in, first-out (FIFO) method	The taxpayer identifies the multiple-asset account with the earliest placed-in-service year that has the same recovery period as the asset disposed of and that has assets at the beginning of the tax year of the disposition. The taxpayer treats the portion of the disposed asset as being from that asset.
Modified FIFO method	The taxpayer identifies the multiple-asset account with the earliest placed-in-service year that has the same recovery period as the asset disposed of and that has assets at the beginning of the tax year of the disposition with the same unadjusted depreciable basis as the disposed asset. The taxpayer treats the portion of the asset disposed of as being from that multiple-asset account.
Mortality dispersion table	The taxpayer uses this method if the disposed asset is part of a mass asset. The taxpayer must base the mortality dispersion table on an acceptable sampling of their actual disposition experience for mass assets or other acceptable statistical or engineering techniques. To use a mortality dispersion table, the taxpayer must adopt recordkeeping practices consistent with the taxpayer's prior practices and in accordance with good accounting and engineering practices.

Note. A **mass asset account** generally includes numerous small-value items. Each item has a nominal value relative to the value of the overall group of mass assets in the account. Identifying any particular item in a mass asset account is generally impractical, and the taxpayer does not typically account for each item individually. Instead, the taxpayer accounts for the total dollar value. See Treas. Reg. §1.168(i)-8 for further details.

In addition to the preceding three methods, the IRS has the authorization to provide other acceptable methods by publishing them in the Federal Register or the Internal Revenue Bulletin.

Note. A last-in, first-out (LIFO) method of accounting **is not permissible**. For information about disposed assets in multiple-asset accounts, see Treas. Reg. §1.168(i)-8.

⁴³ Treas. Reg. §1.168(i)-8(g).

CAPITALIZATION VS. REPAIR DECISIONS

DISTINGUISHING BETWEEN REPAIRS AND IMPROVEMENTS⁴⁴

Qualifying repairs and maintenance costs are not subject to capitalization unless the taxpayer makes an election to capitalize these costs. The taxpayer generally must capitalize improvements unless they elect a safe harbor.

Analyzing specific facts and circumstances is critical in determining whether an expense is a deductible repair or a capitalized improvement. However, establishing the UOP is necessary before this analysis can take place. Upon determination of the UOP, the application of the following tests should proceed in identifying if incurring an expense was to better, adapt, or restore the UOP.

BAR Tests: Betterment, Adaptation, or Restoration

If an expense falls into one of the three “BAR” categories — betterment, adaptation, or restoration — it is considered an improvement to a UOP. Therefore, taxpayers must capitalize those costs unless they claim a safe harbor election. The BAR tests are as follows.

1. **Betterment.**⁴⁵ An amount is paid for a betterment to a UOP if it:
 - a. Ameliorates a material condition or defect that was present before the taxpayer acquired the UOP or that occurred during production;
 - b. Is for a material addition — including a physical enlargement, expansion, extension, or addition of a major component to a UOP — or a material increase in a UOP’s capacity; or
 - c. Is reasonable to expect to materially increase the productivity, efficiency, strength, quality, or output of a UOP.

Note. Upgrading a UOP due to the unavailability of the same size replacement part is not a betterment.⁴⁶ Additionally, an amount incurred to satisfy a regulatory requirement is also not treated as a betterment.⁴⁷

A taxpayer’s expenditure for a UOP may be necessary due to normal wear and tear or damage that occurred during the use of the UOP. In that case, the taxpayer must determine whether the expenditure constitutes a betterment to the UOP. **This determination consists of comparing the property’s condition immediately after the expense with its condition immediately before the circumstances necessitating the expenditure,** using the following guidance.

- In the case of normal wear and tear to a UOP, the condition of the property immediately before the circumstances necessitating the expenditure is the condition of the property after the last time the taxpayer corrected the effects of normal wear and tear (whether the amounts paid were for maintenance or improvements). Or, if the taxpayer has not previously corrected the effects of normal wear and tear, the condition of the property immediately before the circumstances necessitating the expenditure is the condition of the property when placed in service by the taxpayer.
- In the case of damage to a UOP, the condition of the property immediately before the circumstances necessitating the expenditure is the condition of the property immediately before the damage.

⁴⁴ *Tangible Property Regulations — Frequently Asked Questions*. Nov. 10, 2022. IRS. [www.irs.gov/businesses/small-businesses-self-employed/tangible-property-final-regulations] Accessed on Feb. 8, 2023.

⁴⁵ Treas. Reg. §1.263(a)-3(j).

⁴⁶ Treas. Reg. §1.263(a)-3(j)(2)(iii).

⁴⁷ Treas. Reg. §1.263(a)-3(j)(3), example 12.

2. **Adaptation.**⁴⁸ An adaptation prepares a UOP for a new or different use inconsistent with its ordinary use when the taxpayer placed it in service.
3. **Restoration.**⁴⁹ A restoration replaces, returns, or rebuilds a UOP or reinstates a UOP's basis after an adjustment. A restoration includes amounts paid for any of the following purposes.
 - a. Replace a major component of a UOP that the taxpayer properly deducted a loss for that component, other than a casualty loss
 - b. Replace a component of a UOP that the taxpayer properly accounted for the adjusted basis of the component in realizing gain or loss resulting from the sale or exchange of the component
 - c. Restore a UOP that required the taxpayer to take a basis adjustment as a result of a casualty loss
 - d. Return a UOP to its ordinarily efficient operating condition if the UOP deteriorated to a state of disrepair and no longer functions for its intended use
 - e. Rebuild a UOP to a like-new condition after the end of its class life
 - f. Replace the part or combination of parts that comprise a major component or a substantial structural part of a UOP
 - A major component is a part or combination of parts that perform a discrete and critical function in the operation of the UOP.⁵⁰
 - A substantial structural part is a part or combination of parts that comprise a large portion of the physical structure of the UOP.⁵¹

COST SEGREGATION STUDY⁵²

Cost segregation studies can be an effective part of a property owner's annual tax-saving strategy. From its beginnings as an IRS legal memorandum, the practice of employing cost segregation studies in the accounting community has grown and evolved considerably.

Cost segregation is separating a single purchase into multiple depreciation classes. This process allows the taxpayer to maximize shorter depreciation periods instead of keeping the entire purchase cost lumped into one asset with a longer depreciation period. It is important to distinguish between the components and systems of the building and assets that are IRC §1245 (generally, tangible personal property) and those that are IRC §1250 (such as land improvements). Depending on the code section type they fall under, components and systems may be subject to shorter depreciation recovery periods and may qualify for bonus depreciation (when available).

⁴⁸. Treas. Reg. §1.263(a)-3(l).

⁴⁹. Treas. Reg. §1.263(a)-3(k).

⁵⁰. Treas. Reg. §1.263(a)-3(k)(6)(i)(A).

⁵¹. Treas. Reg. §1.263(a)-3(k)(6)(i)(B).

⁵². See *Cost Segregation Audit Technique Guide*. Jun. 1, 2022. IRS. [www.irs.gov/pub/irs-pdf/p5653.pdf] Accessed on Apr. 18, 2023.

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Example 17. Phoenix, Inc. owns a building that it uses in its retail business. The building contains two elevator banks, which consist of three elevators each. Phoenix, Inc. replaces one of the cars to increase the weight capacity rating of one of the elevators. Together, the six elevators comprise a building system. The amount paid by Phoenix, Inc. for a replacement car is a betterment to the building.

Phoenix, Inc. must therefore capitalize and depreciate the cost of the new car over 39 years. However, if Phoenix, Inc. used a cost segregation study to allocate the basis of the building to the various costs of the building structure, it would be able to deduct the remaining basis of the replaced old car.⁵³

Note. Useful information about cost segregation is contained in the IRS Audit Technique Guide found at **uofi.tax/23x2x1** [www.irs.gov/pub/irs-pdf/p5653.pdf]. The document provides industry-specific guidelines for casinos, restaurants, retail industries, the biotech and pharmaceutical industries, and auto dealerships. Additionally, the guide contains issue-specific guidelines for electrical distribution systems.



Practitioner Planning Tip

Cost segregation studies are a valuable service for practitioners to encourage clients to utilize. With bonus depreciation sunseting by the end of 2026 and decreasing by 20% each year beginning in 2023, there is an extra incentive for taxpayers to utilize cost segregation studies sooner rather than later while the bonus depreciation option is still available and results in smaller expense recognition as time passes.⁵⁴

IS A CHANGE IN ACCOUNTING METHOD NECESSARY OR ADVISABLE?

Every business taxpayer has a method of accounting for tax purposes. The taxpayer may adopt this approach through written procedures or by filing a tax return. Practitioners may consider the following questions to determine if their clients should change their accounting methods and, if so, what procedures their clients should follow.

1. What accounting methods does the taxpayer currently use?
2. Are methods the taxpayer currently uses permissible?
 - A taxpayer whose method of accounting complies with the tax rules for capitalization and repairs does **not need** to make a change in accounting method to continue being in compliance. Therefore, they are **not required** to file Form 3115.
 - A taxpayer who chooses to make **elections** or forgoes making elections is not changing their method of accounting. They are **not required** to file Form 3115.⁵⁵
 - Once a taxpayer adopts a proper method of accounting by filing a return using that method, they may **not** adopt a different method of accounting by filing an amended return. To change the method of accounting, the taxpayer must file Form 3115 even if they used the previous method on only one return.⁵⁶

⁵³ Adapted from Treas. Reg. §1.263(a)-3(e)(6), Example 2.

⁵⁴ *Tax Cuts and Jobs Act*, PL 115-97, §13201.

⁵⁵ *Tangible Property Regulations — Frequently Asked Questions*. Nov. 10, 2022. IRS. [www.irs.gov/businesses/small-businesses-self-employed/tangible-property-final-regulations] Accessed on Feb. 8, 2023.

⁵⁶ IRM 4.11.6.3 (2005).

3. Is the taxpayer using impermissible methods that result in a significant misstatement of their tax liabilities? If a mistake affects only one tax return, the taxpayer can amend the affected return without filing Form 3115.⁵⁷ Filing the amended return must precede the filing of next year's return.⁵⁸
4. If the accounting methods used by the taxpayer are not compliant with the tangible property regulations, the taxpayer has the following options to become compliant.
 - The taxpayer can change the method by filing Form 3115 and making an IRC §481(a) adjustment on the current return using the standard calculating method. The §481(a) adjustment will include all transactions treated improperly in all prior tax years.
 - If the taxpayer used the improper method on two consecutive returns, they have established a method of accounting. Therefore, amended returns are not an avenue to change the method of accounting. Form 3115 is required to institute a change to a permissible method.

Even taxpayers in compliance may wish to adopt one or more of the methods approved under the current rules instead of continuing to use their existing accounting procedures. Such a change may produce a more favorable tax result or make tracking assets more practical than the current method.

The best tax result varies based on the taxpayer's circumstances and tax year. Accordingly, the taxpayer should consider the options available for changing to the preferred method and the costs and benefits of each option.

CHANGING AN ACCOUNTING METHOD

TYPES OF ACCOUNTING CHANGES FOR REPAIR REGULATION

Some changes in accounting methods under the tangible property regulations are automatic, while others are not automatic and require IRS review and approval. This section examines the different types of changes that fall into these categories.

Automatic Consent Procedures⁵⁹

The automatic consent procedures allow only the changes listed in Rev. Proc. 2022-14 (or its successors). If the taxpayer meets the conditions and follows the procedures in Rev. Proc. 2022-14, the IRS is automatically deemed to consent for the taxpayer to make the change. **There is no required fee for applications filed under the automatic consent procedures.** The IRS does not acknowledge its approval of applications filed under these procedures.

Generally, a taxpayer may receive automatic consent to change an accounting method by completing and filing Form 3115 and **including it with the timely filed original federal tax return** for the year of change. A taxpayer must also file a signed copy of Form 3115 with the appropriate office.

A taxpayer generally may **not** use automatic consent procedures under the following circumstances. (However, there are exceptions, and the taxpayer should consult Rev. Proc. 2015-13 if they appear to fall under one of these prohibitions.)

1. Within the requested year of change, the taxpayer engages in a liquidation or reorganization transaction to which IRC §381(a) applies.
2. The requested year of change is the final year of the trade or business.
3. The taxpayer made or requested an overall method change during any of the five tax years ending with the year of change.
4. The taxpayer made or requested a change for the same item during any of the five tax years ending with the year of change.

⁵⁷ Rev. Rul. 72-491, 1972-2 CB 104 and Rev. Rul. 90-38, 1990-1 CB 57.

⁵⁸ IRM 4.11.6.3 (2005).

⁵⁹ Rev. Proc. 2015-13, 2015-5 IRB 419 and Rev. Proc. 2022-14, 2022-7 IRB 502.

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If the IRS requires more information after reviewing the requested change, it notifies the taxpayer. In general, the taxpayer must furnish additional information in writing within 30 calendar days from the date of the request. The IRS may grant the applicant an additional 30 calendar days to provide the information if the applicant requests an extension and the IRS deems it appropriate.⁶⁰

A qualifying taxpayer complying with an automatic change request procedure may assume that the IRS granted consent. However, this is true only if:⁶¹

- The affected item(s) are clearly and expressly identified on the taxpayer's Form 3115, and
- The taxpayer complies with all the applicable provisions and implements the change on their federal income tax return for the requested year of change.

Note. In addition to changes related to the tangible property regulations, Rev. Proc. 2022-14 covers the procedures for all other accounting method changes allowed under the automatic consent procedures. Practitioners might be interested in §9 regarding computer software expenditures, §15 regarding changes in overall methods of accounting, or §6.12 relating to changes from impermissible to permissible methods of accounting for depreciation or amortization for disposed depreciable or amortizable property. This last change is a powerful tool to offset the allowed or allowable rule when less than the allowable amount of depreciation was taken.

Nonautomatic Change Requests⁶²

A taxpayer who does not qualify for automatic consent procedures or who requests a change not included in the list of automatic changes may request IRS approval for a nonautomatic change (previously known as advance consent procedures). Form 3115 requesting a nonautomatic change generally must be filed **during the year of the requested change**.

User fees apply to most changes requested under the nonautomatic change procedures. Rev. Proc. 2022-1 (or its successor) provides a list of the applicable fees.

If the IRS requires more information after reviewing the requested change, it notifies the taxpayer. In general, additional information must be furnished in writing within **21 calendar days** from the date of the request. The IRS may grant the applicant an additional 15 calendar days to provide the information if the applicant requests an extension and the IRS deems it appropriate.

The IRS has the right to decline to process any nonautomatic changes requested on Form 3115 in situations in which it would not be in the best interest of sound tax administration to permit the requested change. In this regard, the IRS considers whether the change in method of accounting clearly and directly frustrates compliance efforts of the IRS in administering the income tax laws.

SPECIFICS OF ACCOUNTING CHANGE ADJUSTMENTS UNDER §481(a)⁶³

The Code allows a taxpayer to change their method of accounting from one tax year to another only with the IRS's approval. If said change causes the duplication or omission of income, the Code requires the calculation of an adjustment under §481(a). The taxpayer must make this adjustment for the year of change to prevent such duplication or omission.

The taxpayer calculates the §481(a) adjustment as of the beginning of the tax year of the changed method. The adjustment represents the cumulative difference without regard to the statute of limitations between the present and proposed methods.

⁶⁰ Rev. Proc. 2023-1, 2023-1 IRB 1.

⁶¹ Rev. Proc. 2015-13, 2015-5 IRB 419.

⁶² Rev. Proc. 2023-1, 2023-1 IRB 1.

⁶³ IRM 4.11.6 (2021).

A net positive §481(a) adjustment increases income, resulting in a taxpayer-unfavorable adjustment. A net negative §481(a) adjustment decreases income, resulting in a taxpayer-favorable adjustment.

When a taxpayer uses a voluntary-method change procedure or a regulation provision, a net negative §481(a) adjustment generally takes effect in the year of change. A taxpayer making a voluntary net positive §481(a) adjustment recognizes it over four years starting with the year of change. A taxpayer can also elect under §481(a) to recognize the entire adjustment, if less than \$50,000, as income in the year of change.⁶⁴

Note. When the IRS imposes a method change (an involuntary-method change) resulting from an examination, the taxpayer accounts for the entire net positive or negative §481(a) adjustment in the year of change.

The IRS may determine that certain changes in accounting method require using a **cut-off method** instead of a §481 adjustment.⁶⁵ Under a cut-off method, only the items arising on or after the beginning of the year of change are accounted for under the new method of accounting. The taxpayer continues to account for any items arising before the year of change under the former method of accounting. Because there is no duplication or omission of income when using a cut-off method, no §481(a) adjustment is necessary. The taxpayer may use the cut-off method if they initiated a change specifically allowed or required by a statute or regulation or by the IRS in published guidance.

The IRS grants most automatic accounting method changes with **audit protection**. Consequently, the IRS will not require the taxpayer to change their accounting method for the same item for a tax year prior to the year of change.⁶⁶

Example 18. Gus Industries has been using an impermissible method of accounting for certain items for several years. In 2022, Gus files Form 3115 to change to a proper method of accounting for these items. If Gus makes the change with audit protection, the IRS cannot propose an adjustment for the improper method of accounting for these items in an examination of a tax year prior to 2022.

Observation. This incentive encourages the taxpayer to voluntarily change from an impermissible method to a permissible one when the change results in a positive §481(a) adjustment. If the IRS were to discover the error during an audit, the taxpayer would not be subject to interest or penalties on understatement of tax related to that error because the taxpayer already used an IRS-approved method to correct it.

Example 19. Weston Principles has improperly treated the office equipment it uses as leased assets. Review of the lease agreement shows that Weston actually purchased the office equipment under a 2020 purchasing agreement.

In 2022, Weston purchases additional equipment using the same agreement and wants to account for the new equipment properly. With its 2022 return, Weston files Form 3115 using the automatic consent procedures provided in §6.03 of Rev. Proc. 2022-14. Weston makes this change of accounting method using a cut-off method, and it applies only to transactions occurring on or after the beginning of the year of change.⁶⁷ However, by filing Form 3115, Weston receives audit protection for the 2020 equipment, as it falls under the same item that is subject to the filed Form 3115, and Weston is not under examination. Consequently, the IRS would not require Weston to change its method of accounting for tax years between the year Weston filed Form 3115 and 2020 when Weston purchased the equipment.

⁶⁴ Rev. Proc. 2015-13, 2015-5 IRB 419.

⁶⁵ IRM 4.11.6.5.5 (2017) and Treas. Reg. §1.446-1(e)(3)(ii).

⁶⁶ IRM 4.11.6.6.4 (2021).

⁶⁷ Rev. Proc. 2022-14, 2022-7 IRB 502.

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FILING FORM 3115

General Procedures

Generally, a taxpayer must obtain IRS consent to change from a current accounting method to a new one.⁶⁸ Rev. Proc. 2015-13⁶⁹ provides the general procedures for obtaining IRS consent to change accounting methods. This supersedes the previous guidance provided under Rev. Proc. 97-27 as amplified, clarified, and modified by subsequent revenue procedures.

Rev. Proc. 2022-14⁷⁰ provides the **entire list of automatic changes allowed as of the date it was issued (January 31, 2022)** and specific procedures for each automatic change. This procedure is effective for a Form 3115 filed on or after January 31, 2022, for a year of change ending on or after May 31, 2021. It supersedes Rev. Proc. 2019-43 and Rev. Proc. 2019-48.

The address of the appropriate IRS center to mail a copy of Form 3115 varies depending on the changes made and the type of entity making the changes. The instructions provide a list of those addresses.

When and Where To File.⁷¹ Except as otherwise specifically provided, Form 3115 is filed in duplicate as follows.

1. The taxpayer attaches the original Form 3115 to their timely filed (including extensions) federal income tax return for the year of change.
2. The taxpayer files a copy of Form 3115 with the IRS national office unless Rev. Proc. 2022-14 or other published guidance requires filing the copy with the IRS office in Ogden, Utah. The taxpayer must file the copy no earlier than the first day of the year of change and no later than the date of filing of the original with the federal income tax return for the year of change.

Name and Signature.⁷² In general, the taxpayer is the filer and applicant of Form 3115. The applicant and the filer may not be the same entity in some instances involving consolidated groups and other multiple taxpayers. These situations require obtaining multiple signatures.

For changes requested under the automatic consent procedures, the filer must attach a copy of Form 3115 to the return for the year of change. In addition, the filer must send a signed and dated copy of Form 3115 to the IRS national office or the office in Ogden, Utah. If the individual preparing Form 3115 is not the applicant, the preparer must sign the application. However, the copy of Form 3115 attached to the income tax return does not need to be signed.

In every case, someone signing for the applicant must have personal knowledge of the facts and the authority to bind the filer regarding the matter.

Individuals. Form 3115 requires the name of both spouses on the first line of the application for taxpayers filing a joint income tax return. Both spouses must sign on the signature line.

Partnerships. One of the general partners or limited liability company members must sign on behalf of a partnership.

Corporations. For a nonconsolidated corporation, personal service corporation, S corporation, cooperative, or insurance company, an officer of the entity must sign Form 3115.

Estates and Trusts. The fiduciary, personal representative, executor, administrator, or person acting in one of these capacities must sign Form 3115 for an estate or trust.

⁶⁸ IRC §446(e); *Hawse v. Comm'r*, TC Memo 2015-99 (May 28, 2015).

⁶⁹ Rev. Proc. 2015-13, 2015-5 IRB 419.

⁷⁰ Rev. Proc. 2022-14, 2022-7 IRB 502.

⁷¹ Instructions for Form 3115.

⁷² *Ibid.*

Exempt Organizations. For an exempt organization, a principal officer or person with a similar role must sign Form 3115.

Form 2848.⁷³ A tax practitioner may want to communicate directly with the IRS about the request for a change in accounting method. In such cases, the IRS must have Form 2848, *Power of Attorney and Declaration of Representative*, on file. The taxpayer must sign Form 2848. A person with the authority to appoint a representative must sign for an entity.

Form 2848 must specifically authorize the practitioner to represent the filer before the IRS regarding the requested change in accounting method. A copy of the signed Form 2848 must accompany the copy of Form 3115 mailed to the IRS national office or the office in Ogden, Utah. Without a signed Form 2848, the IRS will not discuss the application with the taxpayer's representative, even if that representative prepared or signed the Form 3115.

Note. The IRS now allows electronic submissions of Form 2848 via e-services and ID.me. The form may also be mailed or faxed. For more information, see the instructions for Form 2848.

Option to Receive Correspondence by Fax.⁷⁴ An applicant may request that the IRS correspond with them by fax instead of by mail regarding Form 3115. The applicant makes this request by attaching a statement to Form 3115. The statement must list the names and fax numbers of the persons who are to receive the fax. The listed persons must have authorization to sign Form 3115 or a representative who has authorization on Form 2848.

Additional Information.⁷⁵ The IRS may request additional information when it processes the request for a change in accounting method. The applicant must respond within a certain time frame, depending on whether the request is under automatic or nonautomatic change procedures as discussed previously. The IRS may impose shorter reply periods for subsequent requests for additional information.

The IRS may grant an extension of time to furnish information. The taxpayer must submit in writing any request for an extension of time. Additionally, the taxpayer must submit these requests before the end of the original deadline. Unusual circumstances may make issuing a written request impractical. In that event, the taxpayer should notify the IRS before the deadline explaining that there is a problem and that they will soon provide the written request for an extension.

The IRS representative reviewing the application has the authority to grant or deny the extension. If the taxpayer should have included the additional information with Form 3115 according to the instructions, the IRS usually denies the extension. Accordingly, the taxpayer should receive prompt notification of the approval or denial of the requested extension. If the IRS denies the extension request, there is no right of appeal.

If the taxpayer does not furnish the required information to the IRS within the reply period, the IRS notifies the taxpayer that the request to change the accounting method has been denied. If the taxpayer wants to submit the additional information at a later date, they must submit it with a new Form 3115 (plus user fee, if applicable). If the deadline for the timely filing of Form 3115 has passed, the change will be effective for the year the new form is timely filed.

Penalties of Perjury Statement for Additional Information. The following declaration must accompany additional information submitted to the IRS.

Under penalties of perjury, I declare that I have examined this information, including accompanying documents, and, to the best of my knowledge and belief, the information contains all the relevant facts relating to the request for the information, and such facts are true, correct, and complete.

The taxpayer or a duly authorized person acting on behalf of the entity must sign this declaration.

⁷³ Ibid.

⁷⁴ Ibid.

⁷⁵ Rev. Proc. 2023-1, 2023-1 IRB 1.

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Requesting a Conference.⁷⁶ As a matter of right, a taxpayer is entitled to one conference with the IRS regarding the application if the IRS indicates that it will reject or disallow the change in accounting method. However, once the IRS denies the request for change, the taxpayer does **not** have the right to appeal to any IRS official.

The applicant may request a conference by checking the box in part II on line 18 of the original Form 3115.⁷⁷ Alternatively, the applicant may make the request in writing after the IRS has indicated that it plans to deny the application.

Depending on the circumstances, a telephone conference may be an option. The taxpayer may request a telephone conference for various reasons. For example, the taxpayer may believe that the issue involved does not warrant the expense of traveling to Washington, DC, or Ogden, Utah. The IRS has the authority to decide if a telephone conference is appropriate in any particular situation. If the IRS approves the request, they will advise the taxpayer when to call the IRS.

After the conference, the taxpayer should furnish the IRS with any additional data, reasoning, precedents, and so on that they proposed and discussed but did not previously or adequately present in writing. The taxpayer must furnish the additional information within **21 calendar days** from the conference date.

Reliance on IRS Consent.⁷⁸ If the national office determines that the consent to a change in accounting method was issued in error or is not in accordance with the IRS's current views, it may revoke or modify its consent by issuing a notice of revocation or modification to the taxpayer. In rare and unusual circumstances, a taxpayer may change their accounting method and is subsequently required to change or modify it. In those cases, the required change or modification will not receive retroactive application if meeting **all** the following conditions.

1. The taxpayer complied with all the applicable provisions.
2. The taxpayer neither misstated nor omitted any material facts.
3. The material facts serving as the basis for the consent have not changed.
4. The applicable law has not changed.
5. The taxpayer, with granted consent, acted in good faith in relying on the consent, and applying the change in accounting method or modification retroactively would be to the taxpayer's detriment.

Procedures Related to the Tangible Property Regulations

The following sections of Rev. Proc. 2022-14 include instructions for automatic changes in accounting methods under the tangible property regulations.

- §6.12: Permissible to permissible method of accounting for depreciation of MACRS property for property in pooled or general asset accounts (GAAs)
- §6.13: Disposition of buildings or structural components
- §6.14: Dispositions of §1245 property and depreciable land improvements
- §6.15: Dispositions of tangible depreciable assets in GAAs⁷⁹
- §11.08: Certain tangible property changes

⁷⁶ Ibid.

⁷⁷ Rev. Proc. 2023-1, 2023-1 IRB 1; Instructions for Form 3115.

⁷⁸ Rev. Proc. 2015-13, 2015-5 IRB 419.

⁷⁹ IRC §168(i)(4) and Treas. Reg. §1.168(i)-1.

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These automatic changes in accounting methods for tangible property have several procedures in common and only minor differences. The following two procedures apply to all five sections listed previously.

1. A single Form 3115 may be used for more than one accounting method change. Practitioners using Form 3115 for multiple changes should review Rev. Procs. 2015-13 and 2022-14 for additional guidance.
2. A taxpayer may use statistical sampling to determine the §481(a) adjustment amount. Rev. Proc. 2011-42 provides specific guidance on statistical sampling for this purpose.

These changes qualify for the “short” Form 3115 for small business taxpayers. For this purpose, small business taxpayers are those with average annual gross receipts of \$10 million or less. The following table summarizes the specific instructions for each section, identifying which portions of Form 3115 small business taxpayers must complete.

Revised Form 3115 Requirements for Small Taxpayers

Change Section	§6.12	§6.13	§6.14	§6.15	§11.08
The identification section of page 1 (above Part I)	X	X	X	X	X
The signature section at the bottom of page 1	X	X	X	X	X
Part I	X	X	X	X	line 1(a) only
Part II					
Lines 4–12, 14, 15a, and 18	X	X	X	X	X
Lines 16a and 16b, if the change is made due to impracticability of calculating basis	X	X	X	X	
Line 15 if the change involves depreciating property					X
Part IV					
Line 25	X				
Lines 26–28	X	X	X	X	X
Line 29	X	X	X	X	
Schedule E					
Line 3	X	X	X	X	If applicable
Additional information required in attachment ^a		X	X	X	X
Statistical sampling may be used to calculate §481(a) adj.		X	X		X
Designated automatic change number	200	205	206	207	^b

^a See the detailed explanations for each section later in the chapter for a list of the additional information that is required.

^b See table later in the chapter under §11.08, Certain Tangible Property Changes.

Note. Special rules apply to public utility property⁸⁰ under all these sections. This chapter does not cover these rules.

The instructions for each section specify which changes combine into one net §481(a) adjustment and which separate into two categories — positive adjustments and negative adjustments — if §481(a) is applicable. If the changes result in two categories of §481(a) adjustments, the taxpayer treats the net negative adjustments under the provisions for immediate recognition. The taxpayer recognizes the net positive adjustments over four years.

⁸⁰ IRC §168(i)(10).

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§6.12 Permissible to Permissible Method for Depreciation for Pooled Assets or GAAs. As mentioned, the automatic change procedures include this set of changes. Because the original accounting method was permissible, a taxpayer can make this change by filing Form 3115. The designated automatic accounting method change number for a change to a method of accounting under this section is **200**.

Section 6.12 of Rev. Proc. 2022-14 applies only to the changes in accounting methods for the depreciation of MACRS property in multiple-asset (i.e., pooled) accounts or GAAs.

To make it easier to calculate MACRS depreciation, a taxpayer may group separate properties into one or more GAAs.⁸¹ The taxpayer depreciates all the assets in a given GAA as a single item of property. The taxpayer makes the election on a timely filed tax return (including extensions) by completing line 18 of Form 4562, *Depreciation and Amortization*, for the year the taxpayer places the property in service.

The changes under this section are grouped into three categories as follows.

1. Changes related to assets that are **not** subject to the GAA election that **qualify** for the simplified procedures for small business taxpayers
2. Changes related to assets that are **not** subject to the GAA election that **do not qualify** for the simplified procedures for small business taxpayers
3. Changes related to assets that are subject to a GAA election. (None of these changes qualify for the simplified procedures.)

A complete list of the changes that may be made under this procedure is provided in the appendix to this chapter. The appendix also specifies the method of making the adjustment for each change. Some changes require a §481(a) adjustment (explained earlier in the chapter), some require making the change using the cut-off method, and others require the taxpayer to use a modified cut-off method.

Definition of the Cut-Off Method. As mentioned previously, under the cut-off method, a taxpayer accounts for only the items arising on or after the beginning of the year of change under the new method of accounting. The taxpayer continues to account for any items arising before the year of change under the former method of accounting. Because there is no duplication or omission of items from income when a taxpayer uses a cut-off method, no §481(a) adjustment is necessary.

Definition of the Modified Cut-Off Method. Under the modified cut-off method, a taxpayer accounts for the unadjusted depreciable basis and the asset's depreciation reserve as of the beginning of the year of change using the proposed method of accounting. See Rev. Proc. 2022-14, §6.12(4)(a), for specific instructions for each change made using this method.

§6.13 Disposition of Buildings or Structural Components. As mentioned, the automatic change procedures include this set of changes. The taxpayer may make all these changes using the simplified procedures under Rev. Proc. 2022-14. The designated automatic accounting method change number for a change to a method of accounting under this section is **205**.

Rev. Proc. 2022-14 §6.13 covers the applicable rules for a change in the accounting method related to the following.

- Disposing of a building or a structural component
- Disposing of a portion of a building (including its structural components) to which the **partial disposition rule** applies

Note. Changes relating to partial dispositions may only be of the type that does **not require an election** on the original return.⁸² See the exceptions in the section “Partial Disposition Election,” earlier in this chapter.

⁸¹ IRS Pub. 946, *How To Depreciate Property*.

⁸² Rev. Proc. 2015-14, 2015-5 IRB 450.

A change of accounting method for dispositions affects the determination of the gain or loss from disposing of these assets. It may also affect whether the taxpayer must capitalize amounts paid to restore a unit of property.

A taxpayer should make a change under this set of procedures if they want to change their method of identifying which assets or portions of assets they disposed of or if they need to correct a partial disposition occurring in a prior year. A taxpayer should also use this set of procedures if they need to remove an asset from the depreciation schedule to claim a gain or loss that occurred in a prior year. Finally, a taxpayer should use this set of procedures to change how they determine the unadjusted basis of assets that they disposed of. The appendix of this chapter provides a complete list of the changes a taxpayer can make under this procedure.

These change procedures do **not apply** to the following.

1. Any multiple buildings, condominium units, or cooperative units that the taxpayer treats as a **single building** under their present method of accounting or that they will treat as a single building under their proposed method of accounting⁸³
2. Any disposition of a portion of an asset requiring a partial disposition election⁸⁴ but for which the taxpayer **did not make such an election**
3. Any demolition of a structure to which IRC §280B and Treas. Reg. §1.280B-1 apply

Information Required with Form 3115. Taxpayers making changes under §6.13 must attach a description of the assets with the applied change to their Form 3115. Depending on the change, the taxpayer must also include the following.

1. If the taxpayer changes how assets are determined, a description of the assets for disposition purposes under the taxpayer's present and proposed accounting methods must accompany Form 3115.
2. If the taxpayer makes a change that involves identifying assets in a multiple-asset account, a description of the methods of identifying which assets have been disposed of under the taxpayer's present and proposed accounting methods must accompany Form 3115.
3. If the taxpayer makes a change that involves assets in the same multiple-asset account, the taxpayer must include a description of the methods of determining the unadjusted depreciable basis of the disposed asset or disposed portion of the asset, as applicable, under the taxpayer's present and proposed accounting methods.
4. If the taxpayer makes a change that involves determining the unadjusted depreciable basis of an asset's **disposed portion**⁸⁵ from an unreasonable method to a reasonable one, they must include a description of the methods of determining the unadjusted depreciable basis of the disposed portion of the asset, as applicable, under the taxpayer's present and proposed accounting methods.

IRC §481(a) Adjustment Period. The following taxpayers must consider the entire amount of the §481(a) adjustment in computing taxable income for the year of change, even if the adjustment is a positive amount.

- A taxpayer making a change in the method of determining which asset (or portion of an asset) has been disposed of if a gain or loss under Temp. Treas. Reg. §1.168(i)-8T has been recognized in a tax year before the year of change
- A taxpayer making a change from recognizing gain or loss under Temp. Treas. Reg. §1.168(i)-8T upon the disposition of an asset⁸⁶ included in a GAA to recognizing gain or loss upon the disposition of the same asset under the final Treas. Reg. §1.168(i)-8

⁸³. Treas. Reg. §1.1250-1(a)(2)(ii).

⁸⁴. Treas. Reg. §1.168(i)-8(d)(2).

⁸⁵. Treas. Reg. §1.168(i)-8(f)(3).

⁸⁶. Treas. Reg. §1.168(i)-8(c)(4)(ii)(A), (B), or (D), as applicable.

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All other taxpayers may claim a negative §481(a) adjustment in the year of change and spread a positive adjustment over four years.⁸⁷

§6.14 Dispositions of Certain Tangible Depreciable Assets. As mentioned, the automatic change procedures includes this set of changes. All these changes qualify for the simplified procedures under Rev. Proc. 2022-14. The designated automatic accounting method change number under this section is **206**.

Section 6.14 of Rev. Proc. 2022-14 covers the applicable rules to change the accounting method related to dispositions of the following assets.

- §1245 property
- Depreciable land improvements
- A portion of §1245 property or depreciable land improvements to which the partial disposition rule applies (Changes under this section may be made only by a taxpayer whose partial disposition was of the type not requiring an election on the original return.)

Note. For further details regarding partial dispositions that do not require an election, see the section “Partial Dispositions Election” earlier in this chapter.

Changes under §6.14 affect the determination of gain or loss from disposing of these assets. It may also affect whether the taxpayer must capitalize amounts paid to restore a UOP.

A taxpayer should make a change under this set of procedures if they want to change their method of identifying which assets or portions of assets they disposed of or if they need to correct a partial disposition occurring in a prior year. A taxpayer should also use this set of procedures if they need to remove an asset from the depreciation schedule to claim a gain or loss that occurred in a prior year. Finally, a taxpayer should use this set of procedures to change how they determine the unadjusted basis of assets of which they disposed. The appendix to this chapter provides a complete list of changes that a taxpayer may make under this procedure.

This section does **not** apply to the following.

1. Any asset⁸⁸ the taxpayer does not depreciate under MACRS under the present method of accounting and, if applicable, under the proposed method of accounting
2. Any building, condominium unit, or cooperative unit or any improvement or addition to such an asset, including any structural component (See §6.13 for changes related to buildings.)
3. Any asset subject to a GAA election⁸⁹ (See §6.12 for changes related to assets subject to the GAA election and §6.15 for changes related to disposing of assets subject to the GAA election.)
4. Any disposition of a portion of an asset requiring a partial disposition election⁹⁰ but for which the taxpayer **did not make such an election**

⁸⁷ Rev. Proc. 2022-14, 2022-7 IRB 502, referencing Rev. Proc. 2015-13, 2015-5 IRB 419.

⁸⁸ Treas. Reg. §1.168(i)-8(c)(4).

⁸⁹ IRC §168(i)(4) and the related regulations.

⁹⁰ Treas. Reg. §1.168(i)-8(d)(2).

Information Required with Form 3115. A taxpayer making a change under §6.14 of Rev. Proc. 2022-14 must attach a description of the assets to which the change applies to their Form 3115. Depending on the change, the taxpayer must also include the following.

1. If a taxpayer makes a change in how assets are determined, they must include a description of the assets for disposition purposes under the taxpayer's present and proposed accounting methods.
2. If a taxpayer makes a change that involves identifying assets in a multiple-asset account, a description of the methods of identifying which assets have been disposed of under the taxpayer's present and proposed accounting methods must accompany Form 3115.
3. If a taxpayer makes a change that involves assets in the same multiple-asset account, the taxpayer must include a description of the methods of determining the unadjusted depreciable basis of the disposed asset or disposed portion of the asset, as applicable, under the taxpayer's present and proposed accounting methods.
4. A taxpayer makes a change that involves determining the unadjusted depreciable basis of an asset's **disposed portion**⁹¹ from an unreasonable method to a reasonable one. The taxpayer must include a description of the methods of determining the unadjusted depreciable basis of the disposed portion of the asset, as applicable, under the taxpayer's present and proposed accounting methods.

IRC §481(a) Adjustment Period for Changes. The following taxpayers must consider the entire amount of the §481(a) adjustment in computing taxable income for the year of change, even if the adjustment is a positive amount.

- A taxpayer making a change in the method of determining which asset (or portion of an asset) has been disposed of if a gain or loss under Temp. Treas. Reg. §1.168(i)-8T has been recognized in a tax year before the year of change
- A taxpayer making a change from recognizing gain or loss under Temp. Treas. Reg. §1.168(i)-8T upon the disposition of an asset included in a GAA to recognizing gain or loss upon the disposition of the same asset under the final Treas. Reg. §1.168(i)-8

All other taxpayers may claim a negative §481(a) adjustment in the year of change and spread a positive adjustment over four years.

§6.15 Dispositions of Tangible Depreciable Assets in GAA. As mentioned, the automatic change procedures include this set of changes. All these changes qualify for the simplified procedures under Rev. Proc. 2022-14. The designated automatic accounting method change number under this section is **207**.

Section 6.15 covers changes related to **disposing** an asset subject to the GAA election.⁹² Changes in these procedures may also affect the determination of gain or loss from the asset's disposal and may affect whether the taxpayer must capitalize amounts paid to restore a UOP.⁹³

A taxpayer should use the procedures in this section if they want to change how they determine which assets they disposed of and the unadjusted depreciable basis of the assets. The appendix to this chapter includes a complete list of covered changes.

⁹¹ Treas. Reg. §1.168(i)-8(f)(3).

⁹² IRC §168(i)(4) and the related regulations.

⁹³ Treas. Regs. §§1.263(a)-3(e) or (f); or Treas. Reg. §1.263(a)-3(k), as applicable.

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This section does **not** apply to the following.

1. Any asset⁹⁴ that the taxpayer is **not** depreciating using MACRS under the present method of accounting and, if applicable, proposed method of accounting
2. Any asset **not** subject to a GAA election

Information Required with Form 3115. A taxpayer making a change under §6.15 must attach a description of the assets to which the change applies to their Form 3115. Depending on the change being made, a taxpayer must also include the following.

1. If a taxpayer makes a change in how assets are determined, they must include a description of the assets for disposition purposes under the taxpayer's present and proposed accounting methods.
2. If a taxpayer makes a change involving identifying assets in a GAA, they must include a description of the methods of identifying which assets they disposed of under the present and proposed accounting methods.
3. A taxpayer makes a change that involves determining the unadjusted depreciable basis of an asset's **disposed portion**⁹⁵ from an unreasonable method to a reasonable one. The taxpayer must include a description of the methods of determining the unadjusted depreciable basis of the disposed portion of the asset, as applicable, under the taxpayer's present and proposed accounting methods.

IRC §481(a) Adjustment Period. When making a change listed in §6.15, taxpayers may claim a negative §481(a) adjustment in the year of change and spread a positive adjustment over four years. However, the calculation of taxable income for the year of change includes the entire amount of a positive §481(a) adjustment if **both** the following conditions are true.

- The taxpayer makes a change in the method of determining which asset or portion of an asset they disposed.
- The taxpayer previously filed Form 3115 and recognized a gain or loss under Temp. Treas. Regs. §1.168(i)-1T or §1.168(i)-8T on the disposition of the asset.

⁹⁴. Treas. Reg. §1.168(i)-1(e)(2)(viii).

⁹⁵. Treas. Reg. §1.168(i)-8(f)(3).

§11.08 Certain Tangible Property Changes. As mentioned, the automatic change procedures include this set of changes. All these changes qualify for the simplified procedures under Rev. Proc. 2022-14. In essence, §11.08 covers changes under the final tangible property regulations⁹⁶ that are not included elsewhere. The automatic accounting method designated change numbers (DCNs) are different for all the types of changes listed, as shown in the following table.⁹⁷

Description of Change	DCN	Treas. Reg. Citations
Change to deducting amounts paid or incurred for repair and maintenance or a change to capitalizing amounts paid or incurred for improvements to tangible property and, if depreciable, to depreciating such property under IRC §§167 or 168. Includes a change, if any, in the method of identifying the unit of property, or in the case of a building, identifying the building structure or building systems for the purpose of making this change	184	§§1.162-4, 1.263(a)-3
Change to the regulatory accounting method	185	§1.263(a)-3(m)
Change to deducting NIMS when used or consumed	186	§§1.162-3(a)(1), (c)(1)
Change to deducting incidental materials and supplies when paid or incurred	187	§§1.162-3(a)(2), (c)(1)
Change to deducting nonincidental rotatable and temporary spare parts when disposed of	188	§§1.162-3(a)(3), (c)(2)
Change to the optional method for rotatable and temporary spare parts	189	§1.162-3(e)
Change by a dealer in property to deduct commissions and other costs that facilitate the sale of property	190	§1.263(a)-1(e)(2)
Change by a nondealer in property to capitalize commissions and other costs that facilitate the sale of property	191	§1.263(a)-1(e)(1)
Change to capitalize acquisition or production costs and, if depreciable, to depreciate such property under §§167 or 168	192	§1.263(a)-2
Change to deduct certain costs for investigating or pursuing the acquisition of real property	193	§1.263(a)-2(f)(2)(iii)

⁹⁶ Treas. Regs. §§1.162-3, 1.162-4, 1.263(a)-1, 1.263(a)-2, or 1.263(a)-3.

⁹⁷ Rev. Proc. 2022-14, 2022-7 IRB 502.

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Section 11.08 does **not** apply to the following.

1. A taxpayer wanting to change their accounting method for dispositions of depreciable property, including a change in the asset disposed of (These are covered under §§6.10, 6.13, 6.14, and 6.15.)
2. Amounts paid or incurred for certain materials and supplies the taxpayer has elected⁹⁸ to capitalize and depreciate
3. Amounts paid or incurred to which the taxpayer has elected⁹⁹ to apply the de minimis safe harbor
4. Amounts paid or incurred for employee compensation or overhead that the taxpayer has elected¹⁰⁰ to capitalize
5. Amounts paid or incurred to which the taxpayer has elected¹⁰¹ to apply the safe harbor for small taxpayers
6. Amounts paid or incurred for repair and maintenance costs that the taxpayer has elected¹⁰² to capitalize
7. Amounts paid or incurred to facilitate the acquisition or disposition of assets that constitute a trade or business¹⁰³
8. Amounts paid or incurred for repair and maintenance costs that the taxpayer is changing from capitalizing to deducting and for which the taxpayer has:
 - a. Claimed a federal income tax credit,
 - b. Elected to apply §168(k)(4) (as in effect on the day before the date of enactment of TCJA), or
 - c. Received a payment for specified energy property in lieu of tax credits under section 1603 of the American Recovery and Reinvestment Tax Act of 2009, Div. B of Pub. L. No. 111-5, 123 Stat. 115 (February 17, 2009), as amended by section 707 of the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, Pub. L. No. 111-312, 124 Stat. 3296 (December 17, 2010).

Information Required with Form 3115. In addition to the other information required on line 14 of Form 3115, the taxpayer must include the following.

1. The taxpayer must include a citation to the paragraph of the regulations that provides for the proposed method(s) of accounting to which the taxpayer is changing.
2. If the taxpayer changes any UOP¹⁰⁴ or the identification of any building structure(s) or building system(s)¹⁰⁵ for purposes of determining whether amounts are deducted as repair and maintenance costs¹⁰⁶ or capitalized as improvement costs,¹⁰⁷ they must include:
 - a. A detailed description of the UOP, building structure(s), or building system(s) used under its present method of accounting;
 - b. A detailed description of the UOP, building structure(s), or building system(s) under its proposed method of accounting; and
 - c. A citation to the paragraph of the final regulation or temporary regulation under which the change in identifying the UOP, building structure, or building system is permitted.
3. A taxpayer changing their method of accounting to capitalize amounts paid or incurred and to depreciate assets must complete Schedule E, *Change in Depreciation or Amortization*, of Form 3115.

⁹⁸. Treas. Reg. §1.162-3(d).

⁹⁹. Treas. Reg. §1.263(a)-1(f).

¹⁰⁰. Treas. Reg. §1.263(a)-2(f)(2)(iv)(B).

¹⁰¹. Treas. Reg. §1.263(a)-3(h).

¹⁰². Treas. Reg. §1.263(a)-3(n).

¹⁰³. See Rev. Proc. 2022-14, 2022-7 IRB 502, for procedures to make changes related to these transactions.

¹⁰⁴. Treas. Reg. §1.263(a)-3(e) (or Temp. Treas. Reg. §1.263(a)-3T(e)).

¹⁰⁵. Treas. Reg. §1.263-3(e)(2) (or Temp. Treas. Reg. §1.263-3T(e)(2)).

¹⁰⁶. Treas. Reg. §1.162-4 (or Temp. Treas. Reg. §1.162-4T).

¹⁰⁷. Treas. Reg. §1.263(a)-3 (or Temp. Treas. Reg. §1.263(a)-3T).

IRC §481(a) Adjustment Period. Most taxpayers changing to a method of accounting under §11.08 of Rev. Proc. 2022-14 may claim a negative §481(a) adjustment in the year of change and spread a positive adjustment over four years.¹⁰⁸ However, the adjustment is limited for certain changes.

For changes to a method of accounting under the following regulations, the §481(a) adjustment **includes only amounts paid or incurred in tax years beginning on or after January 1, 2014.** (Alternatively, a taxpayer may consider amounts paid or incurred in tax years beginning on or after January 1, 2012.)

- Treas. Reg. §1.162-3 (not including §1.162-3(e)) for accounting procedures regarding materials and supplies except the optional method of accounting for rotatable and temporary spare parts
- Treas. Reg. §1.263(a)-2(f)(2)(iii) regarding costs to facilitate the acquisition of real property and allocating those costs to personal property acquired at the same time
- Treas. Reg. §1.263(a)-2(f)(3)(ii) relating to inherently facilitative amounts allocable to the purchase of real or personal property when the property is ultimately not purchased
- Treas. Reg. §1.263(a)-3(m) for adopting the optional regulatory accounting method to determine whether amounts paid to repair, maintain, or improve tangible property are treated as deductible expenses or capital expenditures
- Treas. Reg. §1.263A-1(e)(2)(i)(A) requiring manufacturers to capitalize direct material costs that become an integral part of specific property produced when those materials are consumed in the ordinary course of production and the materials can be identified or associated with particular units or groups of UOP produced
- Treas. Reg. §1.263A-1(e)(3)(ii)(E) requiring manufacturers to capitalize indirect materials costs when those materials are consumed in the ordinary course of production and cannot be identified or associated with particular units or groups of UOP produced

If a taxpayer previously elected to use the repair allowance under Treas. Reg. §1.167(a)-11(d)(2) (which has been repealed), the amount included in the election cannot be included in the §481(a) adjustment. This applies when the taxpayer changes to a method of accounting provided by Treas. Reg. §1.263(a)-3 for improvements to tangible property.

Example 20. Halle's Beauty (Halle) is a calendar-year taxpayer. Halle acquired and placed in service a building and its structural components on July 1, 2008. This property's basis was \$150,000, with \$15,000 (10% of the total cost) attributable to the land and the remaining \$135,000 attributable to the building. The building was capitalized as one asset for depreciation purposes.

In 2019, Halle replaced the building's roof at a cost of \$40,000. It claimed this \$40,000 as a repair on its 2019 tax return. The company did **not** recognize a loss on the retirement of the original roof and continued to depreciate the original roof.

The IRS examined Halle's 2019 return. Upon examination, the IRS disallowed the \$40,000 repair deduction and required that it be capitalized instead.

Halle's CPA, Patience, recommends that the company file Form 3115 with its 2022 corporate income tax return. Filing this form facilitates a deduction of the remaining loss from the roof that was replaced. Because the IRS capitalized the \$40,000 repair cost, a change by the company from depreciating the original roof to recognizing a loss upon its retirement is covered under Rev. Proc. 2022-14, §6.13.

The original building and its components were not accounted for separately for depreciation purposes. Accordingly, the cost of the original roof must be separated from the cost of the entire building using any reasonable method.¹⁰⁹

¹⁰⁸. Rev. Proc. 2022-14, 2022-7 IRB 502, referencing Rev. Proc. 2015-13, 2015-5 IRB 419.

¹⁰⁹. Treas. Reg. §1.168(i)-8(f).

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Patience notes that the FMV of the real estate at the time the roof was replaced in 2019 was \$300,000. Because 10% of the original property's purchase price in 2008 was allocated to the land, Patience allocates 10% of the 2019 FMV of the entire property to the land. Therefore, of the \$300,000 FMV, \$30,000 is allocated to the land. The remaining \$270,000 is the FMV attributable to the building and components.

Patience consults an insurance adjuster who tells her that in their area of the country, the replacement cost is usually 150% of the FMV. Patience uses that estimate to determine that the replacement cost of the entire building would have been \$405,000 ($\$270,000 \times 150\%$). Because it cost \$40,000 to replace the roof, Patience determines that 9.88% ($\$40,000 \div \$405,000$) of the original cost of the building was attributable to the original roof.

As of December 31, 2021, the basis of the building and the accumulated depreciation were \$135,000 and \$46,587, respectively. Patience allocates these amounts as follows.

	Building		Accumulated Depreciation		Adjusted Basis	
Balance on Dec. 31, 2021	\$135,000	\$135,000	\$46,587	\$46,587	\$88,413	\$88,413
Percent allocated to roof	$\times 9.88\%$		$\times 9.88\%$		$\times 9.88\%$	
Amount attributed to roof	\$ 13,338	(13,338)	\$ 4,603	(4,603)	\$ 8,735	(8,735)
Amount attributed to remaining building		\$121,662		\$41,984		\$79,678

Next, Patience determines whether Halle's average annual gross receipts exceed \$10 million. Based on her review of Halle's 2019–2021 tax returns, Patience determines that Halle's average annual gross receipts are \$2 million. Accordingly, Halle qualifies to complete only selected sections of Form 3115 to request a change in accounting procedures under Rev. Proc. 2022-14, §6.13. Patience completes only the required parts and lines of Form 3115. (See the table earlier in this section for the required parts and lines under Rev. Proc. 2022-14.)

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For Example 20

Form **3115**

(Rev. December 2022)
Department of the Treasury
Internal Revenue Service

Application for Change in Accounting Method

Go to www.irs.gov/Form3115 for instructions and the latest information.

OMB No. 1545-2070

Attachment
Sequence No. **315**

Name of filer (name of parent corporation if a consolidated group) (see instructions)	Identification number (see instructions)
Halle's Beauty, Inc.	12-3456789
Number, street, and room or suite no. If a P.O. box, see the instructions.	Principal business activity code number (see instructions)
1 Gotham Lane	456120 (Cosmetics Store)
City or town, state, and ZIP code	Tax year of change begins (MM/DD/YYYY)
New York, NY 10009	01/01/2022
Name of applicant(s) (if different than filer) and identification number(s) (see instructions)	Tax year of change ends (MM/DD/YYYY)
	12/31/2022
Contact person's telephone number	Name of contact person (see instructions)
(315) 555-3265	Patience Philips

Does the filer want to receive a copy of the change in method of accounting letter ruling or other correspondence related to this Form 3115 by fax or encrypted email attachment? If "Yes," see instructions ☐ Yes ☒ No

If the applicant is a member of a consolidated group, check this box ☐

If **Form 2848**, Power of Attorney and Declaration of Representative, is attached (see instructions for when Form 2848 is required), check this box ☒

Check the box to indicate the type of applicant.

- ☐ Individual
- ☒ Corporation
- ☐ Controlled foreign corporation (Sec. 957)
- ☐ 10/50 corporation (Sec. 904(d)(2)(E))
- ☐ Qualified personal service corporation (Sec. 448(d)(2))
- ☐ Exempt organization. Enter Code section: _____
- ☐ Cooperative (Sec. 1381)
- ☐ Partnership
- ☐ S corporation
- ☐ Insurance co. (Sec. 816(a))
- ☐ Insurance co. (Sec. 831)
- ☐ Other (specify): _____

Check the appropriate box to indicate the type of accounting method change being requested.

- See instructions.
- ☐ Depreciation or Amortization
- ☐ Financial Products and/or Financial Activities of Financial Institutions
- ☐ Other (specify): _____

Caution: To be eligible for approval of the requested change in method of accounting, the taxpayer must provide all information that is relevant to the taxpayer or to the taxpayer's requested change in method of accounting. This includes (1) all relevant information requested on this Form 3115 (including its instructions), and (2) any other relevant information, even if not specifically requested on Form 3115.

The taxpayer must attach all applicable statements requested throughout this form.

Part I Information for Automatic Change Request

	Yes	No
1 Enter the applicable designated automatic accounting method change number ("DCN") for the requested automatic change. Enter only one DCN, except as provided for in guidance published by the IRS. If the requested change has no DCN, check "Other," and provide both a description of the change and a citation of the IRS guidance providing the automatic change. See instructions.		
a (1) DCN: 205 (2) DCN: _____ (3) DCN: _____ (4) DCN: _____ (5) DCN: _____ (6) DCN: _____ (7) DCN: _____ (8) DCN: _____ (9) DCN: _____ (10) DCN: _____ (11) DCN: _____ (12) DCN: _____		
b Other ☐ Description: _____		
2 Do any of the eligibility rules restrict the applicant from filing the requested change using the automatic change procedures (see instructions)? If "Yes," attach an explanation		x
3 Has the filer provided all the information and statements required (a) on this form and (b) by the List of Automatic Changes under which the applicant is requesting a change? See instructions	x	
Note: Complete Part II and Part IV of this form, and, Schedules A through E, if applicable.		

Part II Information for All Requests

	Yes	No
4 During the tax year of change, did or will the applicant (a) cease to engage in the trade or business to which the requested change relates, or (b) terminate its existence? See instructions		x
5 Is the applicant requesting to change to the principal method in the tax year of change under Regulations section 1.381(c)(4)-1(d)(1) or 1.381(c)(5)-1(d)(1)?		x
If "No," go to line 6a.		
If "Yes," the applicant cannot file a Form 3115 for this change. See instructions.		

Sign Here	Under penalties of perjury, I declare that I have examined this application, including accompanying schedules and statements, and to the best of my knowledge and belief, the application contains all the relevant facts relating to the application, and it is true, correct, and complete. Declaration of preparer (other than applicant) is based on all information of which preparer has any knowledge.		
	Signature of filer (and spouse, if joint return)	Date	Name and title (print or type)
			Laurel Hadare, President
Preparer (other than filer/applicant)	Print/Type preparer's name	Preparer's signature	Date
	Patience Philips		
	Firm's name Philips CPA		

For Privacy Act and Paperwork Reduction Act Notice, see the instructions.

Cat. No. 19280E

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For Example 20

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Part II Information for All Requests (continued)		Yes	No
6a	Does the applicant (or any present or former consolidated group in which the applicant was a member during the applicable tax year(s)) have any federal income tax return(s) under examination (see instructions)? If "No," go to line 7a.		x
b	Is the method of accounting the applicant is requesting to change an issue under consideration (with respect to either the applicant or any present or former consolidated group in which the applicant was a member during the applicable tax year(s))? See instructions		
c	Enter the name and telephone number of the examining agent and the tax year(s) under examination. Name _____ Telephone number _____ Tax year(s) _____		
d	Has a copy of this Form 3115 been provided to the examining agent identified on line 6c?		
7a	Does audit protection apply to the applicant's requested change in method of accounting? See instructions If "No," attach an explanation.	x	
b	If "Yes," check the applicable box and attach the required statement. ☒ Not under exam ☐ 3-month window ☐ 120 day: Date examination ended _____ ☐ Method not before director ☐ Negative adjustment ☐ CAP: Date member joined group _____ ☐ Audit protection at end of exam ☐ Other _____		
8a	Does the applicant (or any present or former consolidated group in which the applicant was a member during the applicable tax year(s)) have any federal income tax return(s) before Appeals and/or a federal court? If "No," go to line 9.		x
b	Is the method of accounting the applicant is requesting to change an issue under consideration by Appeals and/or a federal court (for either the applicant or any present or former consolidated group in which the applicant was a member for the tax year(s) the applicant was a member)? See instructions If "Yes," attach an explanation.		
c	If "Yes," enter the name of the (check the box) ☐ Appeals officer and/or ☐ counsel for the government, telephone number, and the tax year(s) before Appeals and/or a federal court. Name _____ Telephone number _____ Tax year(s) _____		
d	Has a copy of this Form 3115 been provided to the Appeals officer and/or counsel for the government identified on line 8c?		
9	If the applicant answered "Yes" to line 6a and/or 8a with respect to any present or former consolidated group, attach a statement that provides each parent corporation's (a) name, (b) identification number, (c) address, and (d) tax year(s) during which the applicant was a member that is under examination, before an Appeals office, and/or before a federal court.		
10	If for federal income tax purposes, the applicant is either an entity (including a limited liability company) treated as a partnership or an S corporation, is it requesting a change from a method of accounting that is an issue under consideration in an examination, before Appeals, or before a federal court, with respect to a federal income tax return of a partner, member, or shareholder of that entity?		x
11a	Has the applicant, its predecessor, or a related party requested or made (under either an automatic or non-automatic change procedure) a change in method of accounting within any of the 5 tax years ending with the tax year of change? If "No," go to line 12.		x
b	If "Yes," for each trade or business, attach a description of each requested change in method of accounting (including the tax year of change) and state whether the applicant received consent.		
c	If any application was withdrawn, not perfected, or denied, or if a Consent Agreement granting a change was not signed and returned to the IRS, or the change was not made or not made in the requested year of change, attach an explanation.		
12	Does the applicant, its predecessor, or a related party currently have pending any request (including any concurrently filed request) for a private letter ruling, change in method of accounting, or technical advice? If "Yes," for each request attach a statement providing (a) the name(s) of the taxpayer, (b) identification number(s), (c) the type of request (private letter ruling, change in method of accounting, or technical advice), and (d) the specific issue(s) in the request(s).		x
13	Is the applicant requesting to change its overall method of accounting? If "Yes," complete Schedule A on page 4 of the form.		x

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For Example 20

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Part II Information for All Requests <i>(continued)</i>		Yes	No																		
14	If the applicant is either (i) not changing its overall method of accounting, or (ii) changing its overall method of accounting and changing to a special method of accounting for one or more items, attach a detailed and complete description for each of the following (see instructions): a The item(s) being changed. b The applicant's present method for the item(s) being changed. c The applicant's proposed method for the item(s) being changed. d The applicant's present overall method of accounting (cash, accrual, or hybrid).																				
15a	Attach a detailed and complete description of the applicant's trade(s) or business(es). See section 446(d). b If the applicant has more than one trade or business, as defined in Regulations section 1.446-1(d), describe (i) whether each trade or business is accounted for separately; (ii) the goods and services provided by each trade or business and any other types of activities engaged in that generate gross income; (iii) the overall method of accounting for each trade or business; and (iv) which trade or business is requesting to change its accounting method as part of this application or a separate application. Note: If you are requesting an automatic method change, see the instructions to see if you are required to complete lines 16a-16c.																				
16a	Attach a full explanation of the legal basis supporting the proposed method for the item being changed. Include a detailed and complete description of the facts that explains how the law specifically applies to the applicant's situation and that demonstrates that the applicant is authorized to use the proposed method. b Include all authority (statutes, regulations, published rulings, court cases, etc.) supporting the proposed method. c Include either a discussion of the contrary authorities or a statement that no contrary authority exists.																				
17	Will the proposed method of accounting be used for the applicant's books and records and financial statements? For insurance companies, see the instructions If "No," attach an explanation.																				
18	Does the applicant request a conference with the IRS National Office if the IRS National Office proposes an adverse response?		x																		
19a	If the applicant is changing to either the overall cash method, an overall accrual method, or is changing its method of accounting for any property subject to section 263A, any long-term contract subject to section 460 (see 19b), or inventories subject to section 471 or 474, enter the applicant's gross receipts for the 3 tax years preceding the tax year of change. <table border="1"> <thead> <tr> <th>1st preceding year ended:</th> <th>mo.</th> <th>yr.</th> <th>2nd preceding year ended:</th> <th>mo.</th> <th>yr.</th> <th>3rd preceding year ended:</th> <th>mo.</th> <th>yr.</th> </tr> </thead> <tbody> <tr> <td>\$</td> <td></td> <td></td> <td>\$</td> <td></td> <td></td> <td>\$</td> <td></td> <td></td> </tr> </tbody> </table> b If the applicant is changing its method of accounting for any long-term contract subject to section 460, in addition to completing 19a, enter the applicant's gross receipts for the 4th tax year preceding the tax year of change: 4th preceding year ended: mo. _____ yr. _____ \$ _____	1st preceding year ended:	mo.	yr.	2nd preceding year ended:	mo.	yr.	3rd preceding year ended:	mo.	yr.	\$			\$			\$				
1st preceding year ended:	mo.	yr.	2nd preceding year ended:	mo.	yr.	3rd preceding year ended:	mo.	yr.													
\$			\$			\$															
Part III Information for Non-Automatic Change Request		Yes	No																		
20	Is the applicant's requested change described in any revenue procedure, revenue ruling, notice, regulation, or other published guidance as an automatic change request? If "Yes," attach an explanation describing why the applicant is submitting its request under the non-automatic change procedures.																				
21	Attach a copy of all documents related to the proposed change (see instructions).																				
22	Attach a statement of the applicant's reasons for the proposed change.																				
23	If the applicant is a member of a consolidated group for the year of change, do all other members of the consolidated group use the proposed method of accounting for the item being changed? If "No," attach an explanation.																				
24a	Enter the amount of user fee attached to this application (see instructions) \$ _____																				
b	If the applicant qualifies for a reduced user fee, attach the required information or certification (see instructions).																				

Form **3115** (Rev. 12-2022)

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For Example 20

Form 3115 (Rev. 12-2022)

Page 4

Part IV Section 481(a) Adjustment

	Yes	No
25 Does published guidance require the applicant (or permit the applicant and the applicant is electing) to implement the requested change in method of accounting on a cut-off basis? If "Yes," attach an explanation and do not complete lines 26, 27, 28, and 29 below.		
26 Enter the section 481(a) adjustment. Indicate whether the adjustment is an increase (+) or a decrease (-) in income. \$ <u>(8,735)</u> Attach a summary of the computation and an explanation of the methodology used to determine the section 481(a) adjustment. If it is based on more than one component, show the computation for each component. If the applicant waived any deductions with respect to the method of accounting pursuant to Regulations section 1.59A-3(c)(6)(i), include a summary of the waived deductions. If more than one applicant is applying for the method change on the application, attach a list of the (a) name, (b) identification number, and (c) the amount of the section 481(a) adjustment attributable to each applicant.		
27 Is the applicant required to take into account in the year of change any remaining portion of a section 481(a) adjustment from a prior change (see instructions)? If "Yes," enter the amount. \$		x
28 Is the applicant making an election to take the entire amount of the adjustment into account in the tax year of change? If "Yes," check the box for the applicable elective provision used to make the election (see instructions). ☐ \$50,000 de minimis election ☐ Eligible acquisition transaction election		x
29 Is any part of the section 481(a) adjustment attributable to transactions between members of an affiliated group, a consolidated group, a controlled group, or other related parties? If "Yes," attach an explanation.		x

11 Other costs

Schedule E—Change in Depreciation or Amortization (see instructions)

Applicants requesting approval to change their method of accounting for depreciation or amortization complete this section. Applicants **must** provide this information for each item or class of property for which a change is requested.

Note: See the **Summary of the List of Automatic Accounting Method Changes** in the instructions for information regarding automatic changes under sections 56, 167, 168, or 197, or former sections 168, 1400I, or 1400L. **Do not** file Form 3115 with respect to certain late elections and election revocations. See instructions.

- 1 Is depreciation for the property determined under Regulations section 1.167(a)-11 (CLADR)? ☐ Yes ☐ No
If "Yes," the only changes permitted are under Regulations section 1.167(a)-11(c)(1)(iii).
- 2 Is any of the depreciation or amortization required to be capitalized under any Code section, such as section 263A? ☐ Yes ☐ No
If "Yes," enter the applicable section _____
- 3 Has a depreciation, amortization, expense, or disposition election been made for the property, such as the election under sections 168(f)(1), 168(i)(4), 179, 179C, or Regulations section 1.168(i)-8(d)? ☐ Yes ☒ No
If "Yes," state the election made _____
- 4a Attach a statement describing the property subject to the change. Include the property's description, type, placed-in-service year, and use in the applicant's trade or business or income-producing activity. Also include the type and amount of any federal tax credit claimed or grant received, along with any necessary adjustments to basis required under the Internal Revenue Code, with respect to the property.
- b If the property is residential rental property, did the applicant live in the property before renting it? . . . ☐ Yes ☐ No
- c Is the property public utility property? ☐ Yes ☐ No

To the extent not already provided in the applicant's description of its present method, attach a statement explaining how the

For Example 20

Halle's Beauty, Inc.

FEIN: 12-3456789

Form 3115 Attachment

Information required by Rev. Proc. 2022-14

The taxpayer is changing its method of identifying property disposed of in a prior year. Under the prior method, the roof was capitalized as part of the building and was not separately stated. The IRS has examined the 2019 income tax return of the taxpayer and determined that the roof was replaced in that year. The IRS examination resulted in the capitalization of the roof replacement.

Under the proposed method of accounting, the taxpayer is separating the original cost basis of the replaced roof and claiming a loss on its disposition. For the proposed change, the unadjusted basis of the roof at the time the building was purchased has been determined using the cost to replace the roof as a percentage of the estimated replacement cost of the entire building.

Part II, line 14

- The taxpayer claims a loss on the remaining adjusted basis of the roof component of the building as of December 31, 2021, for the roof that was replaced in 2019.
- Depreciation of the replaced roof was continued after it was disposed of.
- The remaining adjusted basis will be claimed as a loss using the §481(a) adjustment.
- The taxpayer uses the cash method of accounting.

Part IV, line 25

The total §481(a) adjustment for this change is –\$8,735. This represents the remaining basis of the disposed roof as of December 31, 2021.

The original unadjusted basis of the commercial building and its components was \$135,000 when the building was placed into service on July 1, 2008. The building has been depreciated using the midmonth convention on the straight-line basis with a 39-year life.

As of December 31, 2021, the basis of the building and the accumulated depreciation were \$135,000 and \$46,587, respectively. These were allocated based on the assumption that the original cost of the roof was 9.88% of the cost of the building as a whole. This percentage was calculated based on a replacement cost of \$40,000 for the roof and an estimated replacement cost for the entire building of \$405,000 at the time the roof was replaced in 2019.

	Accumulated Building	Depreciation	Adjusted Basis
Balance on Dec. 31, 2021	\$135,000	\$46,587	\$88,413
Percent allocated to roof	$\times 9.88\%$	$\times 9.88\%$	$\times 9.88\%$
Amount attributed to roof	\$ 13,338	\$ 4,603	\$ 8,735

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Halle reports the disposition of the old roof on Form 4797, *Sale of Business Property*.

Form 4797		Sales of Business Property (Also Involuntary Conversions and Recapture Amounts Under Sections 179 and 280F(b)(2))		OMB No. 1545-0184			
Department of the Treasury Internal Revenue Service		Attach to your tax return. Go to www.irs.gov/Form4797 for instructions and the latest information.		2022 Attachment Sequence No. 27			
Name(s) shown on return Halle's Beauty				Identifying number 12-3456789			
1a Enter the gross proceeds from sales or exchanges reported to you for 2022 on Form(s) 1099-B or 1099-S (or substitute statement) that you are including on line 2, 10, or 20. See instructions				1a			
b Enter the total amount of gain that you are including on lines 2, 10, and 24 due to the partial dispositions of MACRS assets				1b			
c Enter the total amount of loss that you are including on lines 2 and 10 due to the partial dispositions of MACRS assets				1c			
Part I Sales or Exchanges of Property Used in a Trade or Business and Involuntary Conversions From Other Than Casualty or Theft—Most Property Held More Than 1 Year (see instructions)							
2	(a) Description of property	(b) Date acquired (mo., day, yr.)	(c) Date sold (mo., day, yr.)	(d) Gross sales price	(e) Depreciation allowed or allowable since acquisition	(f) Cost or other basis, plus improvements and expense of sale	(g) Gain or (loss) Subtract (f) from the sum of (d) and (e)
	Roof	07/01/2008	01/01/2022		4,603	13,338	(8,735)
3	Gain, if any, from Form 4684, line 39						3
4	Section 1231 gain from installment sales from Form 6252, line 26 or 37						4
5	Section 1231 gain or (loss) from like-kind exchanges from Form 8824						5
6	Gain, if any, from line 32, from other than casualty or theft						6
7	Combine lines 2 through 6. Enter the gain or (loss) here and on the appropriate line as follows						7 (8,735)
Partnerships and S corporations. Report the gain or (loss) following the instructions for Form 1065, Schedule K, line 10, or Form 1120-S, Schedule K, line 9. Skip lines 8, 9, 11, and 12 below.							
Individuals, partners, S corporation shareholders, and all others. If line 7 is zero or a loss, enter the amount from line 7 on line 11 below and skip lines 8 and 9. If line 7 is a gain and you didn't have any prior year section 1231 losses, or they were recaptured in an earlier year, enter the gain from line 7 as a long-term capital gain on the Schedule D filed with your return and skip lines 8, 9, 11, and 12 below.							
8	Nonrecaptured net section 1231 losses from prior years. See instructions						8
9	Subtract line 8 from line 7. If zero or less, enter -0-. If line 9 is zero, enter the gain from line 7 on line 12 below. If line 9 is more than zero, enter the amount from line 8 on line 12 below and enter the gain from line 9 as a long-term capital gain on the Schedule D filed with your return. See instructions.						9
Part II Ordinary Gains and Losses (see instructions)							
10	Ordinary gains and losses not included on lines 11 through 16 (include property held 1 year or less):						
11	Loss, if any, from line 7						11 (8,735)
12	Gain, if any, from line 7 or amount from line 8, if applicable						12
13	Gain, if any, from line 31						13
14	Net gain or (loss) from Form 4684, lines 31 and 38a						14
15	Ordinary gain from installment sales from Form 6252, line 25 or 36						15
16	Ordinary gain or (loss) from like-kind exchanges from Form 8824						16
17	Combine lines 10 through 16.						17 (8,735)
18	For all except individual returns, enter the amount from line 17 on the appropriate line of your return and skip lines a and b below. For individual returns, complete lines a and b below.						
a If the loss on line 11 includes a loss from Form 4684, line 35, column (b)(ii), enter that part of the loss here. Enter the loss from income-producing property on Schedule A (Form 1040), line 16. (Do not include any loss on property used as an employee.) Identify as from "Form 4797, line 18a." See instructions							18a
b Redetermine the gain or (loss) on line 17 excluding the loss, if any, on line 18a. Enter here and on Schedule 1 (Form 1040), Part I, line 4							18b

For Paperwork Reduction Act Notice, see separate instructions. Cat. No. 130861 Form **4797** (2022)

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2

Halle's depreciation schedule before capitalizing the \$40,000 repair cost is as follows.

Asset	Date in Service	Cost	Life	Convention	Prior Depreciation	Current Depreciation
Building	7/01/2008	\$135,000	39	MM S/L	\$46,587	\$3,461
Land	7/01/2008	15,000		Land	0	0
Total		\$150,000			\$46,587	\$3,461

Halle's depreciation schedule after capitalizing the \$40,000 repair cost and separating the original roof's depreciable cost from the building cost is as follows.

Asset	Date in Service	Cost	Life	Convention	Prior Depreciation	Current Depreciation
Building	7/01/2008	\$121,662	39	MM S/L	\$41,984	\$3,119
Roof (original)	7/01/2008	13,338	39	MM S/L	4,603	0
Roof (new)	7/01/2019	40,000	39	MM S/L	2,521	1,026
Land	7/01/2008	15,000		Land	0	0
Total		\$190,000			\$49,108	\$4,145

Failure to File Form 3115

In the event that a taxpayer changes their accounting method to comply with tangible property regulations but fails to file Form 3115, if required, the effects are as follows.

1. This constitutes **an unauthorized change of accounting method**.¹¹⁰
2. On examination, the IRS can change the taxpayer's method of accounting to one that it believes most clearly reflects income. In so doing, the IRS may impose a §481(a) adjustment encompassing prior years without regard to a statute of limitations.¹¹¹
3. Any §481(a) adjustment is imposed in one year rather than over a 4-year period as allowed for a voluntary positive §481(a) adjustment.¹¹²
4. If the examination results in an increase in tax, the failure-to-pay penalty may apply to the earlier understatement of tax. The taxpayer may also be subject to accuracy-related and other penalties.¹¹³

SIMPLIFIED PROCEDURE FOR SMALL TAXPAYERS

The IRS did not intend to make complying with the new tangible property regulations burdensome for taxpayers — especially small business taxpayers. The IRS designed the simplified procedure under Rev. Proc. 2015-20¹¹⁴ to make it easier for small business taxpayers to adopt accounting procedures consistent with the new regulations.

¹¹⁰ See Treas. Reg. §1.446-1(e)(2)(i).

¹¹¹ IRC §§481, 1311–1314; *Graff Chevrolet Co. v. Campbell*, 343 F.2d 568 (5th Cir. 1965).

¹¹² Rev. Proc. 2002-18, 2002-13 IRB 678.

¹¹³ Ibid.

¹¹⁴ Rev. Proc. 2015-20, 2015-9 IRB 694.

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Small Business Taxpayer Defined¹¹⁵

To qualify for these simplified procedures, a small business taxpayer must meet **one** of the following conditions.

1. Be a taxpayer with total **assets of less than \$10 million** as of the first day of the tax year for which a change in accounting method is effective
2. Have a separate and distinct trade or business with average annual gross receipts of \$10 million or less for the prior three tax years (The calculation of average annual gross receipts for this purpose uses the same method as the small business safe harbor election.¹¹⁶)

The taxpayer applies the simplified procedure to each separate and distinct trade or business they own. A taxpayer may have more than one separate and distinct trade or business. In that case, they can choose the simplified procedure only for the trades or businesses that meet at least one of the preceding criteria. Therefore, the taxpayer may be able to apply the simplified procedure to some of their businesses but not others.

Simplified Procedure for Changes in Accounting Methods

Rev. Proc. 2015-20¹¹⁷ was issued specifically to address the burden of retroactively changing accounting procedures to comply with the new tangible property regulations. It provides two procedures for the small business taxpayer to change their accounting method for certain depreciable items, as discussed in this chapter.

Under the **first simplified procedure**, the taxpayer **does not file Form 3115**. The taxpayer simply adopts the method with the tax return filed for the **first tax year beginning on or after January 1, 2014**. The taxpayer does not make an adjustment for different methods used prior to January 1, 2014.

The **second simplified procedure** applies to taxpayers who did not change their method of accounting in 2014 for items affected by the new tangible property regulations. Under this procedure, **the taxpayer files Form 3115** but only adjusts for transactions occurring **on or after** January 1, 2014. This cut-off date is in contrast to the usual procedure, which requires that the adjustment include all prior-year transactions affected by the change in accounting procedure.

The following table summarizes the **only types of changes in accounting methods allowable using the simplified procedure**.

¹¹⁵. Ibid.

¹¹⁶. See Treas. Reg. §1.263(a)-3(h)(3).

¹¹⁷. Rev. Proc. 2015-20, 2015-9 IRB 694.

Type of Change in Accounting Method	Section of Rev. Proc. 2022-14	Description of Change in Accounting Method
Certain changes from one permissible method to another permissible method for assets in multiple accounts	§§6.12(3)(a)(iv), (v), (vii), (viii)	This change involves the methods used to identify which assets (or which portion of assets) in multiple-asset accounts have been disposed of as permitted under Treas. Reg. §1.168(i)-8(g).
Changes related to the disposition of buildings or structural components of buildings	§6.13	These rules apply to a taxpayer who wants to make a change in the method of accounting for: • Disposing of a building or a structural component thereof, or • Disposing of a portion of a building (including its structural components) to which the partial disposition rule applies. This change does not apply to any disposition of a portion of an asset for which a partial disposition election¹¹⁸ is required but for which the taxpayer did not make such an election. This change also affects the determination of gain or loss from disposing of the building, the structural component, or the portion of the building (including its structural components). It may also affect whether the taxpayer must capitalize the amounts paid to restore a UOP.
Certain dispositions of tangible depreciable assets (other than a building or its structural components)	§6.14	This change applies to dispositions of the following types of property. • §1245 property • Depreciable land improvements • Portions of §1245 property or depreciable land improvements This change does not apply to any disposition of a portion of an asset for which a partial disposition election¹¹⁹ is required but for which the taxpayer did not make such an election. This change also affects the determination of gain or loss from disposing of these types of property. It may also affect whether the taxpayer must capitalize the amounts paid to restore a UOP.
Certain disposition of tangible depreciable assets in a GAA	§6.15	This section applies to a change in disposing of an asset subject to a GAA election.¹²⁰ This change also affects the determination of gain or loss from disposing of these types of property. It may also affect whether the taxpayer must capitalize the amounts paid to restore a UOP.
Certain tangible property changes	§11.08	This section applies to a change to deducting amounts paid or incurred for repair and maintenance or a change to capitalize amounts paid or incurred for improvements to tangible property and depreciating qualifying property. This change may also involve a change in the method of identifying the UOP, or in the case of a building, identifying the building structure or building systems for the purpose of making this change. Many additional changes are included in this section.

¹¹⁸. Per Treas. Reg. §1.168(i)-8(d)(2).

¹¹⁹. Ibid.

¹²⁰. IRC §168(i)(4) and Treas. Reg. §1.168(i)-1.

DISPOSITIONS UNDER THE TANGIBLE PROPERTY REGULATIONS

The tangible property regulations deem the following situations to be dispositions.

- Transfer of ownership interest in an asset
- Permanent withdrawal of an asset from a taxpayer's trade or business or the production of income
- The sale or exchange of an asset
- The retirement of an asset
- The physical abandonment of an asset
- The destruction of an asset
- The retirement of a structural component (or a portion thereof) of a building (if the partial disposition rule applies)

SALE OF TANGIBLE PROPERTY EXPENSED UNDER DE MINIMIS SAFE HARBOR

When a taxpayer sells or otherwise disposes of property to which they applied the de minimis safe harbor, identifying the treatment of the property is critical. The taxpayer cannot treat that property as a capital asset under IRC §1221 nor as depreciable property used in a trade or business under §1231.¹²¹ It is important to review the basics of §§1221 and 1231.

Review of IRC §§1221 and 1231

IRC §1221 describes a capital asset by stating what it is not. Among other things, a capital asset is not inventory or depreciable business property used in a trade or business. The latter type of property falls under §1231.

A capital asset qualifies for preferential tax treatment when sold, notably in the form of reduced tax rates.¹²² For the 2023 tax year, the capital gain tax rate is as follows.¹²³

Capital Gain Tax Rate	Income Threshold: Single	Income Threshold: Married Filing Jointly
0%	\$0 to \$44,625	\$0 to \$89,250
15%	\$44,626 to \$492,300	\$89,251 to \$553,850
20%	More than \$492,300	More than \$553,850

Note. Higher maximum capital gains tax rates apply to some sales, such as depreciable real estate, some small business stock, and collectibles. In addition, the net investment income tax may apply.

¹²¹. Treas. Reg. §1.263(a)-1(f)(3)(iii).

¹²². IRC §1(h).

¹²³. IRS Pub. 505, *Tax Withholding and Estimated Tax*, p. 34 (2023).

IRC §1231 property must be used in a trade or business and held for over one year. It generally includes all depreciable assets and real property, regardless of whether it is depreciable. Amortizable intangibles, such as acquired goodwill, also are §1231 assets. (Self-created intangibles, such as goodwill generated by a business, are considered capital assets under §1221 and not §1231.) IRC §1231 does not include property held in inventory.

IRC §1231 property receives the best of both worlds regarding tax treatment. Losses are deducted as ordinary income, while gains exceeding the depreciation component qualify for the preferential capital gains tax rates.¹²⁴

Ordinary Income Treatment of Gains¹²⁵

Taxpayers deducting items under the de minimis safe harbor election do not characterize the expenses as capital expenditures under §1231. Instead, **taxpayers treat these expenses as regular business expenses**, provided they qualify as ordinary and necessary expenses incurred in carrying on a trade or business.

Because tangible property deducted under the de minimis safe harbor election cannot be considered capital assets or §1231 property, the income derived from dispositions of such property is **ordinary income**. Consequently, the proceeds of these dispositions do not qualify for preferential capital gain tax treatment.

Example 21. At a bankruptcy auction, Terry Stevens from **Example 11** bought another copier machine for \$800 on January 31, 2021. He used the machine in his business until October 31, 2022, when he sold the equipment for \$1,200.

In 2021, Terry's tax preparer deducted the cost of the copier machine using the de minimis safe harbor election. On his 2022 return, Terry must report the entire \$1,200 sales price as ordinary income. Because Terry is in the 24% tax bracket, he pays \$288 ($\$1,200 \times 24\%$) of income tax on the sale of the machine.

Example 22. Use the same facts as **Example 21**, except in 2021, Terry's tax preparer deducted the \$800 cost of the machine using the §179 election. Terry reports the entire \$1,200 as a gain on his 2022 tax return. However, only the \$800 depreciation component is taxable as ordinary income. The remaining \$400 gain ($\$1,200 - \800) is subject to capital gain tax rates. Because Terry is in the 24% income tax bracket, he pays \$252 ($\$800 \times 24\% + \$400 \times 15\%$) of income tax on the sale of the machine.

BUILDING PROPERTY DISPOSITIONS¹²⁶

If a taxpayer claims deductions for building property improvements under the de minimis safe harbor election, the improvements generally are not sold separately from the rest of the building. Therefore, the improvements are part of the building sale.

The building and corresponding building system components and improvements are reported on the taxpayer's Form 4797. Consequently, **the disposition of building property improvements deducted under the de minimis safe harbor does not trigger self-employment tax or depreciation recapture under §1250.**

¹²⁴. IRS Pub. 544, *Sales and Other Dispositions of Assets*.

¹²⁵. Treas. Regs. §1.263(a)-1(f)(3)(iii) - (iv).

¹²⁶. Treas. Reg. §1.263(a)-1(f)(3); IRC §1402(a)(3)(A).

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APPENDIX

AUTOMATIC CHANGES FOR DISPOSITIONS OF TANGIBLE PROPERTY¹²⁷

The following table summarizes the changes in accounting methods that a taxpayer may make under Rev. Proc. 2022-14.

Final Regulation Section	Section in Rev. Proc. 2022-14	DCN
§1.167(a)-4, Depreciation of leasehold improvements	6.11	199
GAAs		
§1.168(i)-1(c), Change in grouping assets	6.12	200
§1.168(i)-1(e)(2)(viii), Change in determining asset disposed of	6.15	207
§1.168(i)-1(j)(2), Change in method of identifying which assets or portions of assets have been disposed of from one method to another method specified in §1.168(i)-1(j)(2)	6.12	200
§1.168(i)-1(j)(2), Change in method of identifying which assets or portions of assets have been disposed of from a method not specified in §1.168(i)-1(j)(2) to a method specified in §1.168(i)-1(j)(2)	6.15	207
§1.168(i)-1(j)(3), Change in determining unadjusted depreciable basis of disposed asset or disposed portion of an asset from one reasonable method to another reasonable method when it is impracticable from the taxpayer's records to determine the unadjusted depreciable basis of disposed asset or disposed portion of asset	6.12	200
§1.168(i)-1(j)(3), Change in determining unadjusted depreciable basis of disposed asset or disposed portion of an asset from not using to using the taxpayer's records when it is practicable from the taxpayer's records to determine the unadjusted depreciable basis of disposed asset or disposed portion of asset	6.15	207
§1.168(i)-1(j)(3), Change in determining unadjusted depreciable basis of disposed asset or disposed portion of an asset from an unreasonable method to a reasonable method when it is impracticable from the taxpayer's records to determine the unadjusted depreciable basis of disposed asset or disposed portion of asset	6.15	207
Single-Asset Accounts or Multiple-Asset Accounts for MACRS Property		
§1.168(i)-7, Change from single-asset accounts to multiple-asset accounts, or vice versa	6.12	200
§1.168(i)-7(c), Change in grouping assets in multiple-asset accounts	6.12	200

¹²⁷ Rev. Proc. 2022-14, 2022-7 IRB 502.

Final Regulation Section	Section in Rev. Proc. 2022-14	DCN
Dispositions of MACRS Property (not in GAAs)		
§1.168(i)-8(c)(4), Change in determining asset disposed of	6.13 (Building or structural component)	205
	6.14 (Property other than a building or structural component)	206
§1.168(i)-8(f)(2) or (3), Change in determining unadjusted depreciable basis of disposed asset in a multiple-asset account or disposed portion of an asset from one reasonable method to another reasonable method when it is impracticable from the taxpayer's records to determine the unadjusted depreciable basis of disposed asset or disposed portion of asset	6.12	200
§1.168(i)-8(f)(2) or (3), Change in determining unadjusted depreciable basis of disposed asset in a multiple-asset account or disposed portion of an asset from not using to using the taxpayer's records when it is practicable from the taxpayer's records to determine the unadjusted depreciable basis of disposed asset or disposed portion of asset	6.13 (Building or structural component)	205
	6.14 (Property other than a building or structural component)	206
§1.168(i)-8(f)(2) or (3), Change in determining unadjusted depreciable basis of disposed asset in a multiple-asset account or disposed portion of an asset from an unreasonable method to a reasonable method when it is impracticable from the taxpayer's records to determine the unadjusted depreciable basis of disposed asset or disposed portion of asset	6.13 (Building or structural component)	205
	6.14 (Property other than a building or structural component)	206
§1.168(i)-8(g), Change in method of identifying which assets in a multiple-asset account or portions of assets have been disposed of from one method to another method specified in §1.168(i)-8(g)(1) or (2)	6.12	200
§1.168(i)-8(g), Change in method of identifying which assets in a multiple-asset account or portions of assets have been disposed of from a method not specified in §1.168(i)-8(g)(1) or (2) to a method specified in §1.168(i)-8(g)(1) or (2)	6.13 (Building or structural component)	205
	6.14 (Property other than a building or structural component)	206
§1.168(i)-8(h)(1), Change from depreciating a disposed asset or disposed portion of an asset to recognizing gain or loss upon disposition when a taxpayer continues to depreciate the asset or portion that they disposed of prior to the year of change	6.13 (Building or structural component)	205
	6.14 (Property other than a building or structural component)	206
§1.168(i)-8(d)(2)(iii), Partial disposition election for the disposition of a portion of an asset to which the IRS's adjustment pertains	6.10	198

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SPECIFIC AUTOMATIC CHANGES FROM REV. PROC. 2022-14

§6.12: Permissible to Permissible Method for Depreciation of Pooled Assets or GAAs

The following changes allowed under §6.12 are for items of MACRS property that are **not** subject to a GAA election and that qualify under the simplified procedures for small business taxpayers.¹²⁸

1. A change in the method of identifying which assets in multiple-asset accounts or which portions of assets have been disposed of by the taxpayer from the FIFO method of accounting¹²⁹ or the modified FIFO method of accounting¹³⁰ to the specific identification method¹³¹ (using a §481(a) adjustment)
2. A change in the method of identifying which assets in multiple-asset accounts or which portions of assets have been disposed of by the taxpayer from the FIFO method of accounting¹³² to the modified FIFO method of accounting¹³³ or vice versa (using a §481(a) adjustment)
3. A change in the method of identifying which mass assets¹³⁴ in multiple-asset accounts or which portions of mass assets have been disposed of by the taxpayer from the FIFO method of accounting¹³⁵ or the modified FIFO method of accounting¹³⁶ to a mortality dispersion table¹³⁷ (using a §481(a) adjustment)
4. A change in the method of identifying which mass assets¹³⁸ in multiple-asset accounts or which portions of mass assets have been disposed of by the taxpayer from a mortality dispersion table¹³⁹ to the specific identification method,¹⁴⁰ the FIFO method of accounting,¹⁴¹ or the modified FIFO method of accounting¹⁴² (using a §481(a) adjustment)

The following changes allowed under §6.12 are for items of MACRS property that are **not** subject to a GAA election but **do not** qualify under the simplified procedures.

1. A change¹⁴³ from single-asset accounts (or item accounts) for specific items of MACRS property to multiple-asset accounts (or pools) for the same assets or vice versa (using the modified cut-off method, defined later)
2. A change¹⁴⁴ from grouping specific items of MACRS property in multiple-asset accounts to a different grouping of the same assets in multiple-asset accounts (using the modified cut-off method, defined later)

¹²⁸. See IRC §168(i)(4) and related regulations.

¹²⁹. Under Treas. Reg. §1.168(i)-8(g)(2)(i).

¹³⁰. Under Treas. Reg. §1.168(i)-8(g)(2)(ii).

¹³¹. Under Treas. Reg. §1.168(i)-8(g)(1).

¹³². Under Treas. Reg. §1.168(i)-8(g)(2)(i).

¹³³. Under Treas. Reg. §1.168(i)-8(g)(2)(ii).

¹³⁴. As defined in Treas. Reg. §1.168(i)-8(b)(3).

¹³⁵. Under Treas. Reg. §1.168(i)-8(g)(2)(i).

¹³⁶. Under Treas. Reg. §1.168(i)-8(g)(2)(ii).

¹³⁷. In accordance with Treas. Reg. §1.168(i)-8(g)(2)(iii).

¹³⁸. As defined in Treas. Reg. §1.168(i)-8(b)(3).

¹³⁹. In accordance with Treas. Reg. §1.168(i)-8(g)(2)(iii).

¹⁴⁰. Under Treas. Reg. §1.168(i)-8(g)(1).

¹⁴¹. Under Treas. Reg. §1.168(i)-8(g)(2)(i).

¹⁴². Under Treas. Reg. §1.168(i)-8(g)(2)(ii).

¹⁴³. Under Treas. Reg. §1.168(i)-7.

¹⁴⁴. Under Treas. Reg. §1.168(i)-7(c).

3. A change in the method of identifying which assets in multiple-asset accounts or which portions of assets have been disposed of by the taxpayer from the specific identification method¹⁴⁵ to the FIFO method¹⁴⁶ or the modified FIFO method¹⁴⁷ (using a cut-off method and applying to dispositions occurring on or after the beginning of the year of change). A change in the method of identifying which mass assets¹⁴⁸ in multiple-asset accounts or which portions of mass assets have been disposed of by the taxpayer from the specific identification method¹⁴⁹ to a mortality dispersion table¹⁵⁰ (using a cut-off method and applying to dispositions occurring on or after the beginning of the year of change). For disposition of an asset in a multiple-asset account¹⁵¹ when it is impracticable from the taxpayer's records to determine the unadjusted depreciable basis of the asset disposed of, a change in the method of determining the unadjusted depreciable basis of all assets in the same multiple-asset account from one reasonable method to another reasonable method (using a cut-off method and applying to dispositions occurring on or after the beginning of the year of change)
4. For disposition of a portion of an asset¹⁵² when it is impracticable from the taxpayer's records to determine the unadjusted depreciable basis of the disposed portion of the asset, a change in the method of determining the unadjusted depreciable basis of all disposed portions of the asset from one reasonable method to another reasonable method (using a cut-off method and applying to dispositions occurring on or after the beginning of the year of change)

The following changes allowed under this provision are for the items of MACRS property that **are subject** to a GAA election.¹⁵³

1. A change from grouping specific items of MACRS property in GAAs to a different grouping of the same assets in GAAs¹⁵⁴ (using the modified cut-off method, defined earlier)
2. A change in the method of identifying which assets or which portions of assets have been disposed of by the taxpayer from the specific identification method¹⁵⁵ to the FIFO method¹⁵⁶ or the modified FIFO method¹⁵⁷ (using a cut-off method and applying to dispositions occurring on or after the beginning of the year of change)
3. A change in the method of identifying which assets or which portions of assets have been disposed of by the taxpayer from the FIFO method of accounting¹⁵⁸ or the modified FIFO method of accounting¹⁵⁹ to the specific identification method¹⁶⁰ (using a §481(a) adjustment, but the §481(a) adjustment should be zero unless the special rules for terminating GAAs¹⁶¹ apply to the asset subject to the change (See IRS Pub. 946, *How to Depreciate Property*, for more information about terminating a GAA election.)

¹⁴⁵ Under Treas. Reg. §1.168(i)-8(g)(1).

¹⁴⁶ Under Treas. Reg. §1.168(i)-8(g)(2)(i).

¹⁴⁷ Under Treas. Reg. §1.168(i)-8(g)(2)(ii).

¹⁴⁸ As defined in Treas. Reg. §1.168(i)-8(b)(3).

¹⁴⁹ Under Treas. Reg. §1.168(i)-8(g)(1).

¹⁵⁰ In accordance with Treas. Reg. §1.168(i)-8(g)(2)(iii).

¹⁵¹ Under Treas. Reg. §1.168(i)-8(f)(2).

¹⁵² Under Treas. Reg. §1.168(i)-8(f)(3).

¹⁵³ See IRC §168(i)(4) and related regulations.

¹⁵⁴ In accordance with Treas. Reg. §1.168(i)-1(c).

¹⁵⁵ Under Treas. Reg. §1.168(i)-1(j)(2)(i)(A).

¹⁵⁶ Under Treas. Reg. §1.168(i)-1(j)(2)(i)(B).

¹⁵⁷ Under Treas. Reg. §1.168(i)-1(j)(2)(i)(C).

¹⁵⁸ Under Treas. Reg. §1.168(i)-1(j)(2)(i)(B).

¹⁵⁹ Under Treas. Reg. §1.168(i)-1(j)(2)(i)(C).

¹⁶⁰ Under Treas. Reg. §1.168(i)-1(j)(2)(i)(A).

¹⁶¹ See Treas. Reg. §1.168(i)-1(e)(3).

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4. A change in the method of identifying which assets or which portions of assets have been disposed of by the taxpayer from the FIFO method¹⁶² to the modified FIFO¹⁶³ or vice versa (using a §481(a) adjustment, but the §481(a) adjustment should be zero unless the special rules for terminating GAAs¹⁶⁴ apply to the asset subject to the change)
5. A change in the method of identifying which mass assets¹⁶⁵ or which portions of mass assets that are in a separate GAA¹⁶⁶ have been disposed of by the taxpayer from the specific identification method¹⁶⁷ to a mortality dispersion table¹⁶⁸ (using a cut-off method and applying to dispositions occurring on or after the beginning of the year of change)
6. A change in the method of identifying which mass assets¹⁶⁹ or which portions of mass assets that are in a separate GAA¹⁷⁰ have been disposed of by the taxpayer from the FIFO method¹⁷¹ or the modified FIFO method¹⁷² to a mortality dispersion table¹⁷³ (using a §481(a) adjustment, but the §481(a) adjustment should be zero unless the special rules for terminating GAAs¹⁷⁴ apply to the asset subject to the change)
7. A change in the method of identifying which mass assets¹⁷⁵ or which portions of mass assets that are in a separate GAA¹⁷⁶ have been disposed of by the taxpayer from a mortality dispersion table¹⁷⁷ to the specific identification method,¹⁷⁸ the FIFO method,¹⁷⁹ or the modified FIFO method¹⁸⁰ (using a §481(a) adjustment, but the §481(a) adjustment should be zero unless the special rules for terminating GAAs¹⁸¹ apply to the asset subject to the change)
8. A change in the method of determining the unadjusted depreciable basis of all assets in the same GAA from one reasonable method to another reasonable method (using a cut-off method and applying to dispositions occurring on or after the beginning of the year of change) (This change applies¹⁸² if the basis of a disposed asset or a disposed portion of an asset is included in a GAA and it is impracticable from the taxpayer's records to determine the unadjusted depreciable basis of the disposed asset or the disposed portion of the asset.)

¹⁶². Under Treas. Reg. §1.168(i)-1(j)(2)(i)(B).

¹⁶³. Under Treas. Reg. §1.168(i)-1(j)(2)(i)(C).

¹⁶⁴. See Treas. Reg. §1.168(i)-1(e)(3).

¹⁶⁵. As defined in Treas. Reg. §1.168(i)-1(b)(6).

¹⁶⁶. In accordance with Treas. Reg. §1.168(i)-1(c)(2)(ii)(H).

¹⁶⁷. Under Treas. Reg. §1.168(i)-1(j)(2)(i)(A).

¹⁶⁸. In accordance with Treas. Reg. §1.168(i)-1(j)(2)(i)(D).

¹⁶⁹. As defined in Treas. Reg. §1.168(i)-1(b)(6).

¹⁷⁰. In accordance with Treas. Reg. §1.168-1(c)(2)(ii)(H).

¹⁷¹. Under Treas. Reg. §1.168(i)-1(j)(2)(i)(B).

¹⁷². Under Treas. Reg. §1.168(i)-1(j)(2)(i)(C).

¹⁷³. In accordance with Treas. Reg. §1.168(i)-1(j)(2)(i)(D).

¹⁷⁴. See Treas. Reg. §1.168(i)-1(e)(3).

¹⁷⁵. As defined in Treas. Reg. §1.168(i)-1(b)(6).

¹⁷⁶. In accordance with Treas. Reg. §1.168(i)-1(c)(2)(ii)(H).

¹⁷⁷. In accordance with Treas. Reg. §1.168(i)-1(j)(2)(i)(D).

¹⁷⁸. Under Treas. Reg. §1.168(i)-1(j)(2)(i)(A).

¹⁷⁹. Under Treas. Reg. §1.168(i)-1(j)(2)(i)(B).

¹⁸⁰. Under Treas. Reg. §1.168(i)-1(j)(2)(i)(C).

¹⁸¹. See Treas. Reg. §1.168(i)-1(e)(3).

¹⁸². Under Treas. Reg. §1.168(i)-1(j)(3).

§6.13 Disposition of Buildings or Structural Components

Covered changes include the following.

1. A change to the appropriate asset¹⁸³ for purposes of determining which asset or portion of an asset has been disposed of¹⁸⁴
2. A change in how assets are determined, a change from depreciating a disposed asset to recognizing a gain or loss on its disposition, and a change from depreciating such disposed asset to capitalizing the loss sustained in the case of a demolition of a structure¹⁸⁵
3. A change in how assets are determined, a change from depreciating a disposed portion of an asset to recognizing a gain or loss on its disposition, and a change from depreciating such disposed portion of an asset to capitalizing the loss sustained in the case of a demolition of a structure¹⁸⁶
4. A change from depreciating a disposed asset to recognizing a gain or loss upon disposition for dispositions that occurred in a prior tax year (This change applies if the taxpayer's present method of accounting for structural components and buildings, condominium units, and cooperative units, as well as improvements or additions to such assets, is in accordance with the applicable regulations.)¹⁸⁷ and a change from depreciating such disposed asset to capitalizing the loss sustained in the case of a demolition of a structure¹⁸⁸
5. A change from depreciating a disposed portion of an asset to recognizing a gain or loss upon disposition for dispositions that occurred in a prior tax year (This change applies if the taxpayer's present method of accounting for structural components and buildings, condominium units, and cooperative units, as well as improvements or additions to such assets, is in accordance with the applicable regulations.)¹⁸⁹ and a change from depreciating such disposed portion of an asset to capitalizing the loss sustained in the case of a demolition of a structure¹⁹⁰
6. A change in the method of identifying which assets in multiple-asset accounts or which portions of assets have been disposed of from an improper method (e.g., the LIFO method) to an accounting method specified in the regulation¹⁹¹
7. A change in the method of determining the unadjusted depreciable basis of a disposed asset in a multiple-asset account¹⁹² from a method of not using the taxpayer's records to a method of using the taxpayer's records (This change applies when it is practicable from the taxpayer's records to determine the unadjusted depreciable basis of the disposed asset.)

¹⁸³. As determined under Treas. Regs. §§1.168(i)-8(c)(4)(ii)(A), (B), or (D), as applicable.

¹⁸⁴. Based on Treas. Reg. §1.168(i)-8(c)(4).

¹⁸⁵. As defined in Treas. Reg. §1.280B-1.

¹⁸⁶. Ibid.

¹⁸⁷. In accordance with Treas. Regs. §§1.168(i)-8(c)(4)(ii)(A), (B), and (D).

¹⁸⁸. As defined in Treas. Reg. §1.280B-1.

¹⁸⁹. In accordance with Treas. Regs. §§1.168(i)-8(c)(4)(ii)(A), (B), and (D).

¹⁹⁰. As defined in Treas. Reg. §1.280B-1.

¹⁹¹. In accordance with Treas. Regs. §§1.168(i)-8(g)(1) or (2)(i), (ii), or (iii), as applicable.

¹⁹². Under Treas. Reg. §1.168(i)-8(f)(2).

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8. A change in the method of determining the unadjusted depreciable basis of all assets in the same multiple-asset account¹⁹³ from an unreasonable method to a reasonable method (This change applies when it is impracticable from the taxpayer's records to determine the unadjusted depreciable basis of the disposed asset. An example of an unreasonable method is discounting the cost of the replacement asset to its placed-in-service year cost using the Consumer Price Index.)
9. A change in the method of determining the unadjusted depreciable basis of the **disposed portion**¹⁹⁴ of an asset from a method of not using the taxpayer's records to a method of using the taxpayer's records (This change applies when it is practicable from the taxpayer's records to determine the unadjusted depreciable basis of the disposed portion of the asset.)
10. A change in the method of determining the unadjusted depreciable basis of the **disposed portion**¹⁹⁵ of an asset from an unreasonable method to a reasonable method (This change applies when it is impracticable from the taxpayer's records to determine the unadjusted depreciable basis of the disposed portion of the asset.)
11. A change from recognizing gain or loss under Temp. Treas. Reg. §1.168(i)-8T upon the disposition of an asset¹⁹⁶ included in a GAA to recognizing gain or loss upon the disposition of the same asset under Treas. Reg. §1.168(i)-8

§6.14 Dispositions of Certain Tangible Depreciable Assets

Instructions for the following types of changes in accounting method are included in this section.

1. For purposes of determining the asset disposed of, a change to the appropriate asset¹⁹⁷
2. A change in how assets are determined **and** a change from depreciating a disposed asset to recognizing a gain or loss on a disposition that occurred in a prior tax year
3. A change in how assets are determined **and** a change from depreciating a disposed portion of an asset to recognizing a gain or loss on a partial disposition that occurred in a prior tax year
4. A change from depreciating a disposed asset to recognizing a gain or loss upon disposition for dispositions that occurred in a prior tax year (This change applies if the taxpayer's present method of accounting for the covered assets is in accordance with the applicable regulations.)¹⁹⁸
5. A change from depreciating a disposed portion of an asset to recognizing a gain or loss upon disposition for dispositions that occurred in a prior tax year (This change applies if the taxpayer's present method of accounting for the covered assets is in accordance with the applicable regulations.)¹⁹⁹
6. A change in the method of identifying which assets in multiple-asset accounts or which portions of assets have been disposed of from using an improper method (e.g., the LIFO method) to a method of accounting specified in the regulations²⁰⁰

¹⁹³. Under Treas. Reg. §1.168(i)-8(f)(2).

¹⁹⁴. Under Treas. Reg. §1.168(i)-8(f)(3).

¹⁹⁵. Ibid.

¹⁹⁶. As determined under Treas. Regs. §§1.168(i)-8(c)(4)(ii)(A), (B), or (D), as applicable.

¹⁹⁷. As determined under Treas. Regs. §§1.168(i)-8(c)(4)(i), (ii)(C), or (ii)(D), as applicable.

¹⁹⁸. In accordance with Treas. Regs. §§1.168(i)-8(c)(4)(i) or (ii).

¹⁹⁹. Ibid.

²⁰⁰. As determined under Treas. Regs. §§1.168(i)-8(g)(1) or (2)(i), (ii), or (iii), as applicable.

7. A change in the method of determining the unadjusted depreciable basis of a disposed asset in a multiple-asset account²⁰¹ from a method of not using the taxpayer's records to a method of using the taxpayer's records (This change applies when it is practicable from the taxpayer's records to determine the unadjusted depreciable basis of the disposed asset.)
8. A change in the method of determining the unadjusted depreciable basis of all assets in the same multiple-asset account²⁰² from an unreasonable method to a reasonable method (This change applies when it is impracticable from the taxpayer's records to determine the unadjusted depreciable basis of the disposed asset. An example of an unreasonable method is discounting the cost of the replacement asset to its placed-in-service year cost using the Consumer Price Index.)
9. A change in the method of determining the unadjusted depreciable basis of the **disposed portion**²⁰³ of an asset from a method of not using the taxpayer's records to a method of using the taxpayer's records (This change applies when it is practicable from the taxpayer's records to determine the unadjusted depreciable basis of the disposed portion of the asset.)
10. A change in the method of determining the unadjusted depreciable basis of the **disposed portion**²⁰⁴ of an asset from an unreasonable method to a reasonable method (This change applies when it is impracticable from the taxpayer's records to determine the unadjusted depreciable basis of the disposed portion of the asset.)
11. A change from recognizing gain or loss under Temp. Treas. Reg. §1.168(i)-8T upon the disposition of an asset covered in this section that was included in a GAA to recognizing gain or loss upon the disposition of the same asset under Treas. Reg. §1.168(i)-8

§6.15 Dispositions of Tangible Depreciable Assets in a GAA

Instructions for the following types of changes in accounting method are included in this section.

This section applies only to the following changes in methods of accounting for an asset subject to a GAA election.

1. For purposes of determining the asset disposed of,²⁰⁵ a change to the appropriate asset²⁰⁶
2. A change in the method of identifying which assets or which portion of assets have been disposed of from an accounting method not specified in the regulations²⁰⁷ (e.g., the LIFO method) to an accounting method specified in these regulations
3. A change in the method of determining the unadjusted depreciable basis of a disposed asset²⁰⁸ (or portion of an asset) from a method of not using the taxpayer's records to a method of using the taxpayer's records (This change applies when it is practicable from the taxpayer's records to determine the unadjusted depreciable basis of the disposed asset.)
4. A change in the method of determining the unadjusted depreciable basis²⁰⁹ of all assets in the same GAA from an unreasonable method to a reasonable method (This change applies when it is impracticable from the taxpayer's records to determine the unadjusted depreciable basis of the disposed asset. An example of an unreasonable method is discounting the cost of the replacement asset to its placed-in-service year cost using the Consumer Price Index.)

²⁰¹. Under Treas. Reg. §1.168(i)-8(f)(2).

²⁰². Ibid.

²⁰³. Under Treas. Reg. §1.168(i)-8(f)(3).

²⁰⁴. Ibid.

²⁰⁵. Under Treas. Reg. §1.168(i)-1(e)(2)(viii).

²⁰⁶. As determined under Treas. Regs. §§1.168(i)-1(e)(2)(viii)(A) or (B), as applicable.

²⁰⁷. Treas. Regs. §§1.168(i)-1(j)(2)(i)(A), (B), (C), or (D).

²⁰⁸. Under Treas. Reg. §1.168(i)-1(j)(3).

²⁰⁹. Ibid.

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