

Tangible Property Regulations – Is Form 3115 Required?

02.18.15

On Friday, February 13, the IRS issued Rev. Proc. 2015-20, effective for tax years beginning on or after January 1, 2014, providing a "small business exception" for taxpayers to adopt the tangible property regulations without filing Form 3115, Application for Change in Accounting Method, if certain conditions are met.

Note: Taxpayers who utilize the small business exception forgo certain benefits that are only available to taxpayers who file Form 3115 for their first tax year beginning on or after January 1, 2014. The decision regarding whether to apply the small business exception or file Form 3115 must be made before your 2014 income tax return is filed. Below are reasons to consider filing Form 3115 before choosing the appropriate method of compliance.

What Activities Qualify For The Small Business Exception?

Each separate and distinct trade or business, meaning the activity qualifies for its own methods of accounting, qualifies for the small business exception if at least one of the following conditions is met:

1. The activity has total assets of less than \$10 million as of the first day of the taxpayer's first tax year beginning on or after January 1, 2014.
2. Average annual gross receipts of \$10 million or less for the prior three taxable years.

For the determination that an activity qualifies for its own methods of accounting, the most important requirement is that the activity maintains a complete and separable set of books and records.

What To Do:

The taxpayer can choose to employ the small business exception and apply the tangible property regulations prospectively on a cut-off basis. There are no required forms or statements to do this. It is done by not filing a Form 3115 for the tangible property regulations and applying the tangible property regulations accounting methods on current and future returns. If this is done, no forms related to the tangible property regulations can be filed by the taxpayer and no 481(a) adjustment is allowed related to amounts paid or incurred prior to January 1, 2014. The taxpayer continues to be eligible to make any of the tangible property regulation elections and should make any beneficial elections annually.

Where it is determined that there is a benefit to filing Form 3115, the taxpayer should file the applicable forms for the first tax year beginning on or after January 1, 2014 to adopt the tangible property regulations to change impermissible methods and adopt the desired methods.

For each activity that does not qualify for the small business exception, the taxpayer should file the applicable Form 3115 for the first tax year beginning on or after January 1, 2014 to adopt the tangible property regulations to change impermissible methods and adopt the desired methods.

Note: A taxpayer can have some separate and distinct trade or business activities that qualify for the small business exception and others which do not. That would mean Form 3115 would only be required for activities that do not qualify and the taxpayer can still apply the small business exception for the other activities.

Reasons To Consider Filing Form 3115 Even If An Activity Qualifies For The Small Business Exception:

1. Only through filing Form 3115 does the taxpayer qualify for audit protection for the accounting methods being changed. This is important if there would be positive 481(a) adjustments based upon prior year activity.
2. If the small business exception is used by the taxpayer, no Form 3115 can be filed under the tangible property regulations and no 481(a) adjustment is allowable for amounts paid or incurred prior to January 1, 2014. That means no:
 - 481(a) deduction for prior year partial asset disposals
 - 481(a) deduction for items previously capitalized that would qualify to be expensed under restoration, adaptation, betterment, and improvement (RABI) rules
 - 481(a) deduction for change from impermissible to permissible depreciation method with waived scope limitations
 - Ability to correct UNICAP concurrently

3. Outside of filing Form 3115 for the tangible property regulations, there is no clear method for a taxpayer to define unit of property.