

# ***IRS guidance helps taxpayers implement accounting method changes under final disposition regulations***

*November 21, 2014*

## ***In brief***

Rev. Proc. 2014-54 provides the automatic accounting method change procedures for taxpayers to comply with the final disposition regulations (final disposition regulations, final regulations, or disposition regulations) issued on August 14, 2014. The final disposition regulations address the treatment of disposed tangible property (or portions thereof) in a single asset account (SAA), a multiple asset account (MAA), or a general asset account (GAA) under Section 168. The final disposition regulations apply to tax years beginning on or after January 1, 2014, but taxpayers may apply them to tax years beginning on or after January 1, 2012, and before January 1, 2014 (i.e., 2012 and 2013 tax years).

Alternatively, taxpayers may make accounting method changes under the proposed disposition regulations issued on September 13, 2013 (REG-110732-13, the 2013 proposed disposition regulations, or the proposed disposition regulations), and under the temporary regulations issued on December 23, 2011 (T.D. 9564, the 2011 temporary disposition regulations, or the temporary disposition regulations). The guidance for making such accounting method changes is provided in Rev. Proc. 2014-17 (see PwC Tax Insight, “[IRS issues accounting method change procedures for dispositions of tangible depreciable property](#),” February 28, 2014).

## ***In detail***

### ***Background***

The final disposition regulations address the disposition of tangible property under Section 168 – Modified Accelerated Cost Recovery System (MACRS) property. The disposition regulations provide rules to account for an asset (or portion thereof) that is disposed of when in an SAA,

MAA, or GAA. The final disposition regulations apply to tax years beginning on or after January 1, 2014. As noted above, taxpayers may choose to ‘early adopt’ the final disposition regulations for tax years 2012 and 2013. Any taxpayer that wishes to change its methods of accounting for dispositions of tangible property under the final, proposed, or temporary disposition regulations

pursuant to Rev. Proc. 2014-54 or Rev. Proc. 2014-17 must file a Form 3115, *Application for Change in Accounting Method*. Several of the changes provided in Rev. Proc. 2014-54 are the same changes provided in Rev. Proc. 2014-17, but with citations to the final disposition regulations instead of the temporary or proposed disposition regulations.

### **Key aspects of Rev. Proc. 2014-54**

The effective date of Rev. Proc. 2014-54 is September 18, 2014, the date it was released by the IRS. This revenue procedure modifies Rev. Proc. 2014-17 and Rev. Proc. 2011-14, which provide taxpayers with general procedures for obtaining automatic consent for accounting method changes, by adding accounting method changes to the Appendix of Rev. Proc. 2011-14.

The new accounting method changes provided by Rev. Proc. 2014-54 are similar to the accounting method changes provided in Rev. Proc. 2014-17. The key distinction between Rev. Proc. 2014-54 and Rev. Proc. 2014-17 is that Rev. Proc. 2014-54 provides guidance for implementing the final disposition regulations, whereas Rev. Proc. 2014-17 provides guidance for implementing the proposed or temporary disposition regulations. Rev. Proc. 2014-54 also contains transition rules for previously filed accounting method changes under Rev. Proc. 2014-17, scope limitations, audit protection, the use of statistical sampling, and whether each change is implemented with a Section 481(a) adjustment. These items are discussed in more detail below. The charts in the Appendix to this document summarize the accounting method changes that are available under Rev. Proc. 2014-54 and Rev. Proc. 2014-17.

### **Transition rules**

#### *Rev. Proc. 97-27*

Rev. Proc. 2014-54 provides that, if before the effective date of the revenue procedure (September 18, 2014) a taxpayer properly filed an application under Rev. Proc. 97-27 requesting advance consent for an accounting method change described in Rev. Proc. 2014-54 and the application is pending with the IRS National Office as of September 18,

2014, then the taxpayer may request to file the accounting method change under Rev. Proc. 2014-54, if otherwise eligible.

To accomplish this request, the taxpayer must notify the IRS National Office of its intent to make the change under Rev. Proc. 2014-54 prior to the issuance of a letter ruling permitting or denying consent for the change. Upon proper notice by the taxpayer, the IRS National Office will return the Form 3115 to the taxpayer to make necessary modifications and will refund the user fee submitted with the Form 3115.

The Form 3115 will be converted to an application under Rev. Proc. 2014-54 if the taxpayer resubmits the Form 3115 with the necessary modifications. The Form 3115 package also must include a copy of the IRS National Office letter sent with the returned Form 3115. The Form 3115 package must be returned to the IRS in Ogden, UT by the later of (a) the due date specified in section 6.02(3) of Rev. Proc. 2011-14, or (b) 30 calendar days of the date listed on the IRS National Office's letter.

**Note:** Section 6.02(3) of Rev. Proc. 2011-14 provides that a copy of an application in lieu of the IRS National Office copy must be filed with the Ogden office no earlier than the first day of the year of change and no later than the date the taxpayer files the original application with the federal income tax return for the year of change.

#### *Rev. Proc. 2014-17*

If a taxpayer has filed a change under Rev. Proc. 2014-17 and the change was postmarked or received by the IRS on or prior to September 18, 2014, then the taxpayer has made a change under Rev. Proc. 2014-17. Rev. Proc. 2014-54 provides taxpayers with the option to file an amended Form 3115 for the

year of change if, by the due date of the federal income tax return (excluding extensions) for the year of change, the taxpayer:

- files an original or amended return using the new method of accounting pursuant to Rev. Proc. 2014-54;
- attaches the original amended application filed under Rev. Proc. 2014-54 to its amended federal income tax return for the year of change;
- provides specific language at the top of page 1 of the Form 3115 being filed in Ogden; and
- sends the copy of the amended Form 3115 filed with the IRS in Ogden to the address listed in the revenue procedure no later than the date the original amended application is filed with the amended federal income tax return.

### **Audit protection**

The final disposition regulations generally do not modify the general rule that affords audit protection to a taxpayer that voluntarily changes from an improper method of accounting to a method permitted by the final regulations. Specifically, a taxpayer that voluntarily changes from an improper to a proper method of accounting receives a commitment from the IRS that it will not make an examination adjustment relating to the taxpayer's use of the improper method for any prior tax year. Audit protection for changes made under Rev. Proc. 2014-54 begins on the date the Form 3115 is filed with the IRS in Ogden in lieu of the IRS National Office.

However, the final disposition regulations provide that if the item for which an accounting method change

is being requested is a pending issue under examination for any tax year, an issue under consideration by an appeals office, or an issue under consideration by a federal court, then the taxpayer does not receive audit protection under section 7 of Rev. Proc. 2014-54 in connection with that change.

### **Scope limitations**

In general, a taxpayer that is under examination, has engaged in a transaction to which Section 381(a) applies, is in the final year of its trade or business, or has changed its method of accounting for the same item within the past five tax years may not file a change in method of accounting under the automatic consent procedures, but instead must request advance consent under Rev. Proc. 97-27 for such a method change. Rev. Proc. 2014-54, however, waives these 'scope' limitations — contained in section 4.02 of Rev. Proc. 2011-14 — for any tax year beginning before January 1, 2015. Therefore, a taxpayer filing an accounting method change under Rev. Proc. 2014-54 during this period has the ability to file any of the accounting method changes under the automatic consent procedures.

### **Statistical sampling**

Rev. Proc. 2014-54 provides that statistical sampling may be used in determining the Section 481(a) adjustment by following the guidance provided in Rev. Proc. 2011-42.

### **Section 481(a) adjustment**

Some of the accounting method changes require the Section 481(a) adjustment to be taken into account entirely in the year of change regardless of whether the net Section 481(a) adjustment is positive or negative.

**Observation:** Although certain accounting method changes under Rev. Proc. 2014-54 are implemented

with a Section 481(a) adjustment, the timing for taking such adjustment into account may vary from the general rules (e.g., a positive Section 481(a) adjustment may be taken into account entirely in the year of change as opposed to ratably over four tax years). As a result, taxpayers should be aware of the required timing for taking Section 481(a) adjustments into account for each change in method of accounting.

### **Accounting method changes under Rev. Proc. 2014-54**

#### *Accounting method changes that must be filed for tax years beginning before January 1, 2015*

Rev. Proc. 2014-54 provides taxpayers with the ability to file late partial disposition elections and revoke prior GAA elections through accounting method changes for a limited time. Each change is discussed in more detail below.

#### **Late partial disposition election**

Section 6.33 of the Appendix to Rev. Proc. 2011-14, as modified by Rev. Proc. 2014-54, applies to a taxpayer that wants to make a change for the disposition of a portion of an asset (as determined under Reg. sec. 1.168(i)-8(c)(4)).

**Planning opportunity:** Taxpayers should analyze their prior dispositions to determine if any of those dispositions were partial dispositions (e.g., roof of a building). If so, then the late partial disposition election accounting method change affords taxpayers the ability to take into account the remaining basis of the portion of the asset in the year of change (e.g., 2014). As mentioned above, taxpayers have a limited time period to make the late partial disposition election accounting method change. Thus, a timely analysis of prior dispositions to identify partial dispositions is imperative.

**Note:** If a partial disposition is claimed for a portion of an asset, then the amount related to replacing that portion is treated as a capitalized restoration. Therefore, taxpayers should consider the benefits and costs of taking a partial disposition and capitalizing the amount of the replacement. If the replacement portion of the asset does not rise to the level of a capitalized expenditure, then it may be advantageous to forgo the partial disposition and claim the repair expense on such replacement costs.

#### **Revocation of GAA elections**

Section 6.34 of the Appendix to Rev. Proc. 2011-14, as added by Rev. Proc. 2014-54, applies to a taxpayer that wants to revoke prior GAA elections made under:

- section 6.32 of the Appendix to Rev. Proc. 2011-14, as modified by Rev. Proc. 2014-17, for one or more items of MACRS property included in the GAAs, or
- the temporary or proposed disposition regulations for one or more items of MACRS property placed in service by the taxpayer in a tax year beginning on or after January 1, 2012, and before January 1, 2014.

**Observation:** As noted above, taxpayers have a limited window to revoke GAA elections. Due to the strict rules that apply to GAAs along with what constitutes a qualifying disposition under the final disposition regulations, taxpayers with assets in a GAA that plan to make partial dispositions and would like to recognize the gain or loss associated with those partial dispositions should file an accounting method change to revoke the related GAA elections.

**Planning opportunity:** If a taxpayer places a building in service in the current tax year and plans to

demolish such building in the future, then the taxpayer may wish to elect GAA treatment for the building when filing its federal income tax return. Such election is made on Form 4562, *Depreciation and Amortization*. By electing GAA treatment for the building, the taxpayer may continue to depreciate the building when demolished rather than capitalizing the remaining basis into the land under Section 280B. However, due to the restrictive definition of qualifying dispositions, a taxpayer will not be able to make a partial disposition election for dispositions of portions or structural components of the building in a GAA. Thus, taxpayers should analyze the benefits and costs of placing a building in a GAA.

#### *Accounting method changes for property in a GAA, MAA, or SAA*

**Partial disposition election for the disposition of a portion of an asset to which the IRS's adjustment pertains**  
Section 6.35 of the Appendix to Rev. Proc. 2011-14, as modified by Rev. Proc. 2014-54, provides a change for a taxpayer that wants to make a partial disposition election for the disposition of a portion of an asset if the IRS determines that the cost of replacing that portion is subject to capitalization.

**Observation:** The taxpayer-favorable provision provides that if the IRS denies the treatment of an item as a current expense and requires such expense to be capitalized, then a taxpayer may file an accounting method change for the disposed-of portion to elect partial disposition treatment. In doing so, the taxpayer will immediately recover its basis in the disposed-of portion of the asset while capitalizing its replacement.

#### **Depreciation of leasehold improvements**

Rev. Proc. 2014-54 did not change or modify the existing guidance in Rev. Proc. 2014-17 related to the depreciation of leasehold improvements. Thus, a taxpayer that wants to change its method of accounting to comply with Reg. sec. 1.167(a)-4 for leasehold improvements in which the taxpayer has a depreciable interest at the beginning of the year of change should refer to Rev. Proc. 2014-17, which provides the applicable procedures for this accounting method change.

#### **Permissible to permissible method of accounting for depreciation of MACRS property**

Rev. Proc. 2014-54 modifies the changes made under section 6.37 of the Appendix to Rev. Proc. 2011-14, as added by Rev. Proc. 2014-17. This change applies to a taxpayer currently using a permissible method of accounting for depreciating MACRS property that wishes to make a change to another permissible method of accounting for MACRS property.

Originally, Rev. Proc. 2014-17 added two changes in methods of accounting for items of MACRS property not subject to a GAA election under Section 168(i)(4) and the regulations thereunder. However, Rev. Proc. 2014-54 added eight accounting method changes for such items and includes eight additional accounting method changes for items of MACRS property subject to a GAA election pursuant to Section 168(i)(4) and the regulations thereunder.

If a taxpayer has not made a valid GAA election, then it may make a change from an SAA to a MAA (or pooling), and from one pooling method to another. If a taxpayer has made a valid GAA election, then it may make a change from one GAA to another GAA (with a different

grouping of the same assets). The additional changes in methods of accounting relate to identifying the asset disposed of from these accounts (specific identification, FIFO, modified FIFO, or mortality dispersion table). Rev. Proc. 2014-54 provides the specific requirements for taxpayers that wish to make a change under this section.

#### *Accounting method changes for property not in a GAA (i.e., in a MAA or SAA)*

#### **Disposition of a building or structural component**

Rev. Proc. 2014-54 provides accounting method change procedures applicable to dispositions of a building (including its structural components) under section 6.38 of the Appendix to Rev. Proc. 2011-14, as modified by Rev. Proc. 2014-54. More specifically, the changes under section 6.38 apply to a building, condominium unit, cooperative unit, structural component, or an improvement or addition thereto. These procedures also affect the determination of gain or loss from the disposition of the building, the structural component, or the portion of the building (including its structural components) to which the partial disposition rule in Reg. sec. 1.168(i)-8(d)(1) applies.

Specifically excluded from this method change is property for which a valid GAA election has been made or any demolition of a structure subject to Section 280B and Reg. sec. 1.280B-1.

**Observation:** Although Rev. Proc. 2014-54 precludes taxpayers from making any change under section 6.38 for property for which a valid GAA election has been made, the revenue procedure allows taxpayers to revoke their GAA elections. Taxpayers that have property in GAAs but wish to make a change under this section for dispositions of such property should

also file a change under section 6.40 of the Appendix to Rev. Proc. 2011-14, as modified by Rev. Proc. 2014-54, to revoke the GAA elections for dispositions of such property (discussed below).

**Note:** Rev. Proc. 2014-54 permits taxpayers to file both changes on a single Form 3115. It is also important to note that under the final regulations, for dispositions of buildings, the asset is defined as each building and its structural components. This is an important difference from the 2011 temporary disposition regulations, under which a disposition of a building did not include its structural components because the building and its structural components were treated as separate assets.

#### Disposition of tangible depreciable assets other than a building or its structural components

Section 6.39 of the Appendix to Rev. Proc. 2011-14, as modified by Rev. Proc. 2014-54, sets forth the accounting method change procedures for the disposition of tangible depreciable assets other than a building or its structural components. Taxpayers may make this method change for Section 1245 property or a depreciable land improvement to comply with the final disposition regulations. This change will affect the determination of gain or loss from the disposition of the Section 1245 property or the depreciable land improvement.

Procedures for how a taxpayer may change its methods of accounting for Section 1245 property, a depreciable land improvement, or an improvement or addition thereto also are included under this change.

Consistent with section 6.38 of the Appendix to Rev. Proc. 2011-14, changes under section 6.39 of Rev. Proc. 2014-54 are not applicable to property for which a valid GAA election has been made.

**Observation:** Because taxpayers have the ability to revoke their GAA elections under Rev. Proc. 2014-54, a taxpayer can make this change for such assets if it revokes the applicable GAA election. Similar to section 6.38 of the Appendix to Rev. Proc. 2011-14, as modified by Rev. Proc. 2014-54, section 6.39 of Rev. Proc. 2014-54 also permits taxpayers to file both changes on a single Form 3115.

#### Accounting method change for property in a GAA

#### Disposition of tangible depreciable assets in a GAA

Taxpayers may make a method change under section 6.40 of the Appendix to Rev. Proc. 2011-14, as modified by Rev. Proc. 2014-54, for assets for which the taxpayer has made a valid GAA election, to comply with the final disposition regulations. This change may affect the determination of gain or loss from the disposition of an asset from a GAA. Rev. Proc. 2014-54 also provides additional details regarding the specific changes covered by this method change for assets for which the taxpayer has made a valid GAA election.

Specifically excluded from this method change are (1) property that is not depreciated under Section 168, and (2) property for which a valid GAA election has not been made. See discussion above for such assets.

**Planning opportunity:** For property in a GAA, taxpayers should assess the need to keep such property

in a GAA. As discussed above, Rev. Proc. 2014-54 allows taxpayers to revoke their GAA elections. By revoking GAA elections, taxpayers are able to take partial dispositions on property when components are disposed of. Revocation of GAA elections is available only for tax years beginning before January 1, 2015.

#### The takeaway

Rev. Proc. 2014-54 is designed to assist taxpayers with implementing accounting method changes required to comply with the final disposition regulations. Because taxpayers must comply with the disposition regulations for the first tax year that begins on or after January 1, 2014, taxpayers should analyze their current accounting methods for dispositions and determine the changes that will need to be made under the final regulations.

In addition, taxpayers have a limited opportunity for tax years beginning before January 1, 2015, to make, via an automatic method change, a retroactive partial disposition election to claim partial disposition losses. Taxpayers should evaluate this opportunity to claim additional losses, while recognizing that claiming such losses may result in the capitalization of the costs to restore such disposed property.

## **Let's talk**

For a deeper discussion of how this might affect your business, please contact:

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#### **SOLICITATION**

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## **Appendix - List of accounting method changes**

The charts below provide the applicable accounting method changes under the final and 2013 proposed disposition regulations, the designated (automatic) change number (DCN), and the citation.

### **A. Final disposition regulations - Filed under Rev. Proc. 2014-54**

<b>DCN</b>	<b>Description of change</b>	<b>Citation</b>
180	6.32 General asset account elections	Reg. sec. 1.168(i)-1 Reg. sec. 1.168(i)-1T Prop. Reg. sec. 1.168(i)-1
196	6.33 Late partial disposition election	Reg. sec. 1.168(i)-8 Prop. Reg. sec. 1.168(i)-8
197	6.34 Revocation of a general asset account election	Reg. sec. 1.168(i)-1 Reg. sec. 1.168(i)-1T Prop. Reg. sec. 1.168(i)-1
198	6.35 Partial dispositions of tangible depreciable assets to which the IRS's adjustment pertains	Reg. sec. 1.168(i)-8 Prop. Reg. sec. 1.168(i)-8
200	6.37 Permissible to permissible method of accounting for depreciation of MACRS property	Reg. sec. 1.168(i)-1, Reg. sec. 1.168(i)-7, Reg. sec. 1.168(i)-8
205	6.38 Disposition of a building or structural component	Reg. sec. 1.168(i)-8
206	6.39 Dispositions of tangible depreciable assets (other than a building or its structural components)	Reg. sec. 1.168(i)-8
207	6.40 Dispositions of tangible depreciable assets in a general asset account	Reg. sec. 1.168(i)-1

**B. 2013 Proposed disposition regulations – Filed under Rev. Proc. 2014-17**

<b>DCN</b>	<b>Description of change</b>	<b>Citation</b>
175	6.27 Depreciation of leasehold improvements	Reg. sec. 1.167(a)-4T
176	6.28 Permissible to permissible method of accounting for depreciation of MACRS property	Reg. sec. 1.168(i)-1T, Reg. sec. 1.168(i)-7T, Reg. sec. 1.168(i)-8T, Prop. Reg. sec. 1.168(i)-1, Prop. Reg. sec. 1.168(i)-7, Prop. Reg. sec. 1.168(i)-8
177	6.29 Disposition of a building or structural component	Reg. sec. 1.168(i)-8T, Prop. Reg. sec. 1.168(i)-8
178	6.30 Dispositions of tangible depreciable assets (other than a building or its structural components)	Reg. sec. 1.168(i)-8T, Prop. Reg. sec. 1.168(i)-8
179	6.31 Dispositions of tangible depreciable assets in a general asset account	Reg. sec. 1.168(i)-1T, Prop. Reg. sec. 1.168(i)-1
199	6.36 Depreciation of leasehold improvements	Reg. sec. 1.167(a)-4