

Accounting Methods

Chapter 7

§199

Research Credit

Form **3115**
(Rev. December 2015)
Department of the Treasury
Internal Revenue Service

Application for Change in Accounting Method

► Information about Form 3115 and its separate instructions is at www.irs.gov/form3115.

Form **8903**
(Rev. December 2010)
Department of the Treasury
Internal Revenue Service

Domestic Production Activities Deduction

► Attach to your tax return. ► See separate instructions.

Form **6765**
Department of the Treasury
Internal Revenue Service

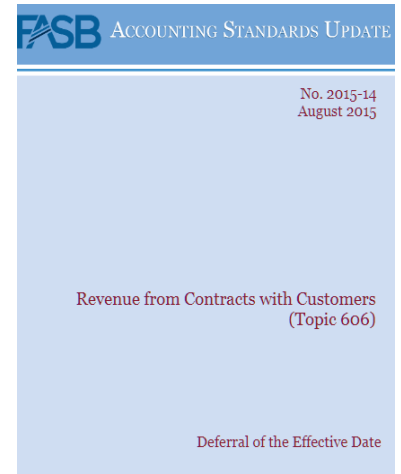
Credit for Increasing Research Activities

► Attach to your tax return.
► Information about Form 6765 and its separate instructions is at www.irs.gov/form6765.

Methods Developments

Revenue Recognition GAAP Changes & Tax Relevance

- **GAAP changes effective:**
 - For public business entities, certain non-profits, and certain employee benefit plans (period beginning after 12/15/17)
 - Others for periods beginning after 12/15/18
- **Will create new book-tax differences unless the business desires to adopt the book method for tax**
 - Method change considerations



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Revenue Recognition – Relevance to Practice

- Understand GAAP guidance and identify clients affected
 - “Who Is Affected by the Amendments in this Update?”
 - The guidance in this Update affects any entity that either enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of nonfinancial assets unless those contracts are within the scope of other standards (for example, insurance contracts or lease contracts). ...” [FASB]
 - AICPA resources
<https://www.aicpa.org/InterestAreas/FRC/AccountingFinancialReporting/RevenueRecognition/Pages/default.aspx>
- Compare to tax methods
- Plan for preparation of Forms 3115 and §481(a) adjustments (unless cut-off applies)

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Proposed Rev Proc – Notice 2017-17

- IRS sought comments on proposed rev proc on method changes related to FASB/IASB new standard – “Revenue from Contracts with Customers (Topic 606)”
 - FASB Update No. 2014-09
 - IASB International Financial Reporting Standard (IFRS) 15
- Notice includes list of questions; comments due 7/24/17
- Automatic change
 - Cut-off proposed for small businesses
 - < \$10 million assets or \$10 million or less of average gross receipts in prior 3 years

Form 3115 Application for Change in Accounting Method (OMB No. 1545-0047)

Part I Information for Automatic Change Request

1. Enter the applicable assigned automatic accounting method change number (AAMC) for the requested automatic change. Enter only one AAMC, except as provided for in guidance published by the IRS. If the requested change has no AAMC, check "Other" and provide both a description of the change and a citation of the IRS guidance providing the automatic change. See instructions.

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.

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.

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.

5. Is the applicant requesting to change to the principal method in the tax year of change under Regulations section 1.2612(a)(1)-(3) or 1.2612(b)(1)-(3)?

If "No," go to line 6a.

If "Yes," the applicant cannot file a Form 3115 for this change. See instructions.

Part II Information for All Requests

6. 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.

7. Is the applicant requesting to change to the principal method in the tax year of change under Regulations section 1.2612(a)(1)-(3) or 1.2612(b)(1)-(3)?

If "No," go to line 6a.

If "Yes," the applicant cannot file a Form 3115 for this change. See instructions.

Sign Here

Preparer (Print name) _____ Date _____
 Taxpayer (Print name) _____ Date _____

Revised List of Automatic Method Changes

- Rev. Proc. 2017-30 (4/19/17)
- Various modifications including related to TPR changes
 - New items:
 - Organizational expenditures under §248 and §709.
 - Changes from currently deducting inventory to a permissible method of identifying and valuing inventories.

<https://www.irs.gov/pub/irs-irbs/irb17-18.pdf>

“Taxpayer” As Cash or Accrual

- *Gregory*, 149 TC No. 2 (7/11/17)
 - §468 - Special rules for mining and solid waste reclamation and closing costs
 - (1) ALLOWANCE OF DEDUCTION If **taxpayer** elects application of this section with respect to any mining or solid waste disposal property, amount of any deduction for qualified reclamation or closing costs for any taxable year to which such election applies shall be equal to the current reclamation or closing costs ...
 - §468 reference to “taxpayer” means cash or accrual
 - G – accrual books and cash tax return
 - G made election
 - Court – ok to use §468.

Depreciation Updates

Start of Depreciation on a Building

AOD 2017-02 (4/10/17) – *Stine, LLC*, No. 13-03224 (WD LA, 2015)

- Court allowed depreciation on 2 retail buildings
 - Certificate of occupancy existed, but not yet open for business and certificate did not let public in, BUT could install equipment and stock shelves.
 - IRS equipment cases n/a to building.
- IRS – no depreciation until ready for intended function
 - Retail – needs to be open for customers
 - Need to look at “property’s specifically assigned function” and when in state of readiness for that function.
 - **AOD – NA**

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Allocation Between Land and Building

- *Nielsen*, TC Summary Opinion 2017-31 (5/8/17)
 - 3 residential rentals in California
 - N claimed depreciation on full cost (land and building)
 - IRS adjusted using improvement/land allocation on property tax bill
 - 44.4%, 38% and 31%
 - N argues that 38% should be 46% and that Assessor info “is extraordinarily inaccurate and internally inconsistent.”
 - But no evidence to support that.
 - Court holds for IRS

Review of allocation rules

- Reg. 1.167(a)-5 – depreciable basis can't exceed proportion of structure value to total value at acquisition date.
- *Meiers*, TC Memo 1982-51 – court agreed with t/p that assessor allocation for 2 condos was “grossly disproportionate to the actual purchase price of the properties ... no evidence” that they “comport with reality”
 - Assessor had almost 50/50 split (for condos)
 - Taxpayer used 80% for structure

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Review of allocation rules

- IRS, ATG Cost Segregation – Chapter 5

FMV property
Less FMV land
 Improvements value

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Allocation reminders

Consider:

- Information at acquisition date.
- Valid appraisal is likely to override a property tax assessment allocation but it is a good idea to have info to support why assessor's allocation is not justified.
- Any information that indicates a higher value for land than claimed on return needs to be justified. Even land with improvements might only be worth the value of the land. Thus, important to be able to show appropriate value of the improvement.

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2008 GAO Recommendation

- For rental real estate - Require individuals to separately list basis of land and structure on return
- GAO, *Tax Gap – Actions That Could Improve Rental Real Estate Reporting Compliance*, GAO-08-956
- <http://www.gao.gov/new.items/d08956.pdf>

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Cost Seg ATG Updated

Topics covered:

[Preface - 2016 Update](#)
[Introduction](#)
[Legal Framework](#)
[Cost Segregation Approaches](#)
[Principal Elements of a Quality Cost Segregation Study and Report](#)
[Review and Examination of a Cost Segregation Study](#)
Special Topics
[Uniform Capitalization](#)
[Change in Accounting Method](#)
[Depreciation Overview](#)
[Relevant Court Cases](#)
[Inherently Permanent Standard](#)
[Construction Process](#)
[Information Document Requests](#)
[Bonus Depreciation](#)
Industry Specific Guidance
[Casinos](#)
[Restaurants](#)
[Retail Industries](#)
[Biotech & Pharmaceutical Industry](#)
[Auto Dealerships](#)
[Auto Manufacturing](#)
Issue Specific Guidance
[Electrical Distribution System](#)
[Stand-Alone Open-Air Parking Structure](#)

<https://www.irs.gov/businesses/cost-segregation-audit-techniques-guide-table-of-contents>

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R&D Developments

§174 Clarifications

- CCA 20170501F (2/3/17)
 - Electric utility company
 - Findings include:
 - If §174(a) is method and did not deduct some R&D, per RR 58-74, amend open years to fix.
 - Item is “pilot model” if a model of product produced to evaluate and resolve uncertainty during development. Would not yet be commercially proven and available.
 - “A demonstration presumes a successful, capable and functional operation that is based on proven technology and therefore, inherently contradicts the position that the Plant is experimental and was built to resolve technical uncertainty.”

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Research Credit / Payroll Credit Guidance

- Notice 2017-23
 - Interim guidance
 - Basics, definitions, examples
 - Comments requested by 7/17/17
 - Special amended return option
 - If file return for tyba 2015 and don't elect to claim research credit as payroll credit, can amend that return by 12/31/17 to do so.
 - “FILED PURSUANT TO NOTICE 2017-33” at top of Form 6765

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Research Tax Payroll Credit Clarification

- AM2017-003 (7/31/17)
 - Beyond Notice 2017-23
 - When to start using credit against FICA tax
 - Includes specific examples
 - Starts in qtr/Form 941 in quarter following when income tax return with Form 6765 filed.
 - If for tyba 2015 made late election, can't use until quarter after amended return filed
- Also see Form 941 instructions

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IRS Directive on Research Tax Credit

- Sept 2017 – collaboration of IRS, PwC and Silicon Valley Tax Director's Group
- Key elements
 - For LB&I taxpayers
 - US GAAP financial statement following ASC 730, R&D
 - Provide specified information
 - Safe harbor
 - So intended to reduce computation and audit time.

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Appendix B - Reconciliation of Form 6765 QREs to Adjusted ASC 730 Financial Statement R&D

Appendix B - Reconciliation of Form 6765 QREs to Adjusted ASC 730 Financial Statement R&D

		A	B	C	D
Form 6765 Line Number	Description	Adjusted ASC 730 Financial Statement R&D QRE Amounts: From Appendix C	Additional QRE Amounts From ASC 730 accounts not included in Adjusted ASC 730 Financial Statement R&D	Additional QRE Amounts Not From ASC 730 accounts	Total QRE Amounts claimed on Form 6765
		A	B	C	A + B + C = D
5 or 24	Wages for qualified services (do not include wages used in figuring the work opportunity credit)	xx,xxx,xxx	xx,xxx,xxx	xx,xxx,xxx	xx,xxx,xxx
6 or 25	Cost of supplies	xx,xxx,xxx	xx,xxx,xxx	xx,xxx,xxx	xx,xxx,xxx

Tax Reform and Methods

H.R. 1 as amended

- §448 increased to \$25 million, adj for inflation
- §263A new exception for small as defined in §448
- §471 new exception for small as defined in §448
 - Treat inventory as non-incidentals supplies or per "applicable financial statement."
- §460(e) – bumped to \$25 million
- §162(r) - no deduction allowed for any law firm expense resulting from case compensated primarily on contingent basis until contingency resolved (reverses *Boccardo* (9th Cir. 1995))

SFC Proposal

- §448 changed to \$15 million
- Similar for §263A, §471 and §460
- Repeal *Boccardo* case too.
- Craft beverage – exempt aging period for beer, wine and distilled spirits from consideration as production (avoid interest capitalization)
 - Expires for tyba 12/31/19; effective for interest costs paid or incurred after 12/31/17



Tax Reform and Method Changes

- If desire to accelerate deductions into last high rate year and defer income to first low tax year ...
 - Also consider automatic method changes (Rev Proc. 2017-30)
 - IF otherwise makes sense (are permanent changes).
 - Costs of making the change (completion of Form 3115 and calculation and use of 481(a) adjustment)

Tax
Reform
and §199



Tax Reform and R&D

- Research tax credit retained
- H.R. 1, as amended – amortize §174 R&E over 5 years starting for tyba 12/31/22