

AN ALERT FROM THE BDO FEDERAL TAX PRACTICE

# BDO KNOWS:

## FEDERAL TAX



### SUBJECT

## IRS INCREASES DE MINIMIS SAFE HARBOR THRESHOLD FOR TAXPAYERS WITHOUT APPLICABLE FINANCIAL STATEMENTS BEGINNING IN 2016

### SUMMARY

On November 24, 2015, the Internal Revenue Service issued an advance version of [Notice 2015-82](#), which increases the de minimis safe harbor threshold for deducting certain capital items from \$500 to \$2,500 for small businesses without applicable financial statements. The increased threshold will simplify the paperwork and recordkeeping requirements of small businesses by enabling the immediate deduction of amounts paid or incurred to acquire, produce, or improve tangible property. The new \$2,500 limit applies to any such item substantiated by an invoice.

This notice is effective for costs incurred during taxable years beginning on or after January 1, 2016. Additionally, the IRS will provide audit protection to eligible businesses by not challenging amounts deducted up to the \$2,500 threshold in tax years prior to 2016. The de minimis safe harbor threshold for taxpayers with an applicable financial statement remains at \$5,000.

### DETAILS

#### *Background*

On September 17, 2013, the Treasury Department and IRS issued final regulations (T.D. 9636) to provide guidance on the application of sections 162(a) and 263(a) of the Internal Revenue Code (“Code”) to amounts paid to acquire, produce, or improve tangible property (“final tangible property regulations”). The final tangible property regulations are applicable to taxable years beginning on or after January 1, 2014.

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One of the more favorable components of these regulations is the provision of a de minimis safe harbor election. Intended as an administrative convenience for small dollar expenditures, the de minimis safe harbor election permits a taxpayer to not capitalize, or treat as a material or supply, certain amounts paid for tangible property that it acquires or produces during the taxable year provided the taxpayer meets certain requirements and the property does not exceed certain dollar limitations. If the requirements are met, amounts paid for the qualifying property generally may be deducted under section 162, provided the amount otherwise constitutes an ordinary and necessary business expense in carrying on a trade or business. See Treas. Reg. section 1.263(a)-1(f).

A taxpayer with an applicable financial statement (“AFS”), such as a financial statement required to be filed with the Securities and Exchange Commission or a certified audited financial statement accompanied by the report of an independent CPA, may elect to apply the de minimis safe harbor if, in addition to other requirements, the amount paid for the property does not exceed \$5,000 per invoice (or per item as substantiated by the invoice) and the taxpayer treats the amount paid as an expense on its AFS in accordance with its written accounting procedures. In contrast, a taxpayer without an AFS may elect to apply the de minimis safe harbor if, in addition to other requirements, the amount paid for the property subject to the de minimis safe harbor does not exceed \$500 per invoice (or per item as substantiated by the invoice).

After the final tangible property regulations were issued, the Treasury Department and the Service received more than 150 comment letters from representatives of small business taxpayers without an AFS requesting an increase in the de minimis safe harbor threshold.

### ***Increased Limit And Audit Protection***

*Based on the feedback and balancing the goal of the final regulations to reduce administrative burden, the Service announced in Notice 2015-82 that the de minimis safe harbor threshold for a taxpayer without an AFS is increased from \$500 to \$2,500. Taxpayers can elect annually to expense costs up to \$2,500 without an AFS. The new \$2,500 threshold is effective for costs incurred during taxable years beginning on or after January 1, 2016.*

Aside from the increased threshold, the remaining regulatory requirements for the de minimis safe harbor remain in place for taxpayers without an AFS. That is, the de minimis safe harbor may be followed up to the \$2,500 level per invoice (or per item as substantiated by the invoice) if the taxpayer:

- 1) Does not have an AFS,
- 2) Has accounting procedures as of the beginning of the year specifying a dollar amount beneath which amounts will be expensed for non-tax purposes,
- 3) Expenses the amount paid for the property on its books and records in accordance with the accounting procedures, and
- 4) Elects annually to apply the de minimis expense safe harbor by attaching a statement to the taxpayer’s timely filed original Federal tax return (including extensions) for the taxable year in which the amounts are paid.

Note: The de minimis safe harbor is not intended to limit a taxpayer’s ability to deduct otherwise deductible repair and maintenance costs that exceed the safe harbor threshold. As before, small businesses without an AFS can still claim otherwise deductible repair and maintenance costs, even if they exceed the \$2,500 threshold.

In addition, the Service states in Notice 2015-82 that it will provide audit protection to eligible businesses by not challenging use of the new \$2,500 threshold in tax years prior to 2016. For taxable years beginning before January 1, 2016, the Service will not raise upon examination the issue of whether a taxpayer without an AFS can utilize the de minimis safe harbor for an amount not exceeding \$2,500 per invoice (or per item as substantiated by invoice) provided the regulatory requirements are otherwise satisfied. Going a step further, if the taxpayer’s use of the de minimis safe harbor is an issue under consideration in an examination, appeals, or before the U.S. Tax Court in a taxable year beginning after December 31, 2011, and ending before January 1, 2016, and the issue pertains to the qualification of an amount not exceeding \$2,500, then the Service will not further pursue the issue, provided the regulatory requirements are otherwise satisfied.

The de minimis safe harbor threshold for taxpayers with an applicable financial statement remains at \$5,000.

## BDO INSIGHTS

The increased de minimis safe harbor threshold in Notice 2015-82 is welcome relief to many small businesses that do not have audited financial statements. As a result of the higher threshold, small businesses will be able to immediately deduct many small dollar expenditures that would otherwise need to be spread over a period of years through annual depreciation deductions, thereby simplifying paperwork and easing the burden of complying with the tangible property regulations.

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