

AN ALERT FROM THE BDO FEDERAL TAX PRACTICE

# BDO KNOWS:

## FEDERAL TAX



### SUBJECT

## IRS INTRODUCES THREE NEW AUTOMATIC METHOD CHANGES AND PROVIDES MODIFIED PROCEDURES

### SUMMARY

On May 5, 2016, the Internal Revenue Service (“IRS” or “Service”) issued Revenue Procedure 2016-29 to update the list of automatic changes in methods of accounting as applied under Rev. Proc. 2015-13. In addition to adding three new automatic accounting method changes, the Rev. Proc. modifies certain existing automatic method changes, extends the waiver of certain eligibility waivers, and provides limited transition rules.

For federal income tax purposes, once a taxpayer has adopted or established a method of accounting, that method, whether proper or improper, must continue to be used until the taxpayer files a Form 3115, *Application for Change in Accounting Method*, to secure the Service’s consent to change to a different method. There are more than two hundred automatic method changes listed in Rev. Proc. 2016-29; taxpayers should carefully review the changes to identify any opportunities to file automatic Form 3115 requests to secure IRS consent to change to the most optimal method of accounting in order to reduce taxable income and increase cash tax savings.

Rev. Proc. 2016-29 generally supersedes Rev. Proc. 2015-14, and is effective for automatic accounting method change requests filed on or after May 5, 2016, for a taxable year of change ending on or after September 30, 2015. In light of the immediate effective date of this revenue procedure, all Form 3115 requests filed under the automatic procedures set forth in Rev. Proc. 2015-13 must now be filed pursuant to this new procedure.

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## DETAILS

### *New Automatic Method Changes*

Rev. Proc. 2016-29 contains a list of over two hundred automatic method changes. In general, if the method change is identified as automatic by the Service, the Form 3115 request is subject to lower IRS scrutiny (i.e., the taxpayer is deemed to have “automatic consent” to change to the new method of accounting), there is no user fee, and the deadline for filing the request is extended. If a method change is not identified as automatic by the Service, or the taxpayer did not meet an eligibility requirement under Rev. Proc. 2015-13, the taxpayer is required to file a non-automatic Form 3115. A non-automatic change is subject to greater IRS scrutiny, requires an IRS user fee, and must be filed no later than the last day of the year of change. A favorable development in Rev. Proc. 2016-29 is the addition of three new automatic method change procedures relating to the following Internal Revenue Code sections:

- ▶ **Start-up expenditures under Section 195 (Automatic Change #223):** This new automatic procedure applies to a change in the characterization of an item as a start-up expenditure, or a change in the determination of the taxable year in which the taxpayer’s active trade or business to which the start-up expenditures relate begins.
- ▶ **Interest capitalization under Section 263A (Automatic Change #224):** This new automatic procedure applies to a change in which interest is capitalized with respect to the product of designated property, when previously no such interest was capitalized, or such interest was not capitalized in accordance with its book method of accounting, in accordance with sections 1.263A-8 through 14 of the Income Tax Regulations.
- ▶ **Certain changes within the retail inventory method under Section 471 (Automatic Change #225):** This new automatic procedure applies to a taxpayer using the retail inventory method and is changing from including to not including temporary markups and markdowns in determining the retail selling prices of goods on hand at the end of the taxable year.

### *Modifications to Existing Method Changes*

Rev. Proc. 2016-29 sets forth significant changes, among others, to existing automatic method changes.

The Service provides that the following method changes must now be made under the non-automatic change procedures of Rev. Proc. 2015-13:

- ▶ Change from impermissible to permissible methods of depreciation or amortization to any property for which a taxpayer has claimed a federal income tax credit such as the rehabilitation credit under section 47.
- ▶ Change from capitalizing to deducting amounts paid or incurred for repair and maintenance costs for which the taxpayer has claimed a federal income tax credit or elected to apply section 168(k)(4).
- ▶ Change to the percentage-of-completion method for long-term contracts under section 460.

Additionally, the Service made modifications to the automatic changes in connection with the remodel-refresh safe harbor guidance for restaurants and retailers described in Rev. Proc. 2015-56. Notably, the automatic change #221 under section 6.20 of Rev. Proc. 2016-29 has been modified to provide that the revocation of a partial disposition election under the safe harbor must be made, and certain eligibility rules in Rev. Proc. 2015-13 do not apply, for any tax year beginning after December 31, 2013, and ending before December 31, 2016. Previously, this revocation had to be made and the eligibility rules did not apply for the first or second tax year beginning after December 31, 2013. Similarly, the Service modified automatic change #222 under section 11.10 of Rev. Proc. 2016-29 to provide that certain eligibility rules in Rev. Proc. 2015-13 do not apply for any tax year beginning after December 31, 2013, and ending before December 31, 2016.

### *Extension of Eligibility Waiver*

Normally, taxpayers are not permitted to make an automatic method change if they made a change to the same item within the previous five tax years, among other things. This eligibility requirement was previously waived under Rev. Proc. 2015-13 for changes that implemented the tangible property regulations for any tax year beginning before January 1, 2015. This waiver has now been extended by Rev. Proc. 2016-29 to any tax year beginning before January 1, 2016.

### ***Effective Date and Limited Transition Relief***

Rev. Proc. 2016-29 is effective for automatic accounting method change requests filed on or after May 5, 2016, for a taxable year of change ending on or after September 30, 2015.

Rev. Proc. 2016-29 provides transition rules for Form 3115 requests that were previously filed under the non-automatic method change procedures where the applicable method change is now an automatic method change. If the non-automatic Form 3115 was filed prior to May 5, 2016 under Rev. Proc. 2015-13 and remains pending with the IRS National Office as of that date, the taxpayer may notify the Service to convert the application into an automatic change.

In addition, Rev. Proc. 2016-29 eliminated certain automatic method changes previously available under the now-superseded Rev. Proc. 2015-14. By default, such method changes must now be filed under the non-automatic change procedures of Rev. Proc. 2015-13. If the taxpayer properly filed the original or the duplicate copy of a Form 3115 under the prior automatic change procedures before May 5, 2016, that method change remains automatic. However, if the taxpayer did not properly file the original or the duplicate copy of such Form 3115, that method change must be filed non-automatically.

## **BDO INSIGHTS**

- ▶ Automatic Form 3115 requests filed after May 5, 2016 for a taxable year of change ending before September 30, 2015, may be filed under Rev. Proc. 2015-14. However, if the taxable year of change ends on or after September 30, 2015, taxpayers are required to adhere to the updated procedures of Rev. Proc. 2016-29 when preparing automatic Form 3115 applications. It is important to note that certain section numbers have been modified as a result of Rev. Proc. 2016-29. For example, the automatic change #23 for section 263A, or uniform capitalization for producers and reseller-producers, which was previously filed under section 11.02 of Rev. Proc. 2015-14, has been renumbered as section 12.02 of Rev. Proc. 2016-29.
- ▶ Over time, as more and more automatic method changes are instituted, it is expected that the Service will periodically issue a new automatic change Revenue Procedure to provide the latest list of changes.

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