Depreciation
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# Table of Contents

**Introduction** ....................................................................................................................................................... 1  
Tangible property capitalization and repair regulations ............................................................................................... 1  
   Recent history ............................................................................................................................................................ 1  
      Accounting method changes ......................................................................................................................................... 2  
      Filing deadlines .......................................................................................................................................................... 3  
   Working the regulations to the taxpayer’s benefit ........................................................................................................ 7  
      Tangible property flowchart ......................................................................................................................................... 8  
   De minimis safe harbor election — Treas. Regs. §1.263(a)-1(f) ................................................................................ 8  
      Safe harbor election rules and amounts ..................................................................................................................... 9  
   Election ......................................................................................................................................................................... 11  
   Safe harbor for small taxpayers with buildings .......................................................................................................... 12  
      Small taxpayer .......................................................................................................................................................... 13  
      Qualified building ..................................................................................................................................................... 13  
      Cliff test ................................................................................................................................................................. 13  
      Making the election .................................................................................................................................................. 13  
   Safe harbor for routine maintenance — Treas. Regs. §1.263(a)-3(i) ............................................................ 15  
      “Routine” ............................................................................................................................................................... 15  
      Ineligible expenses .................................................................................................................................................. 15  
   Materials and supplies — Treas. Regs. §1.162-3 ........................................................................................................... 16  
      When to deduct ........................................................................................................................................................ 16  
      Rotable, temporary and standby emergency spare parts .......................................................................................... 17  
      Election to capitalize rotatable, temporary, and standby emergency spare parts .............................................. 18  
      Accounting method changes ........................................................................................................................................ 18  
   Election to capitalize repair and maintenance expenditures — Treas. Regs. §1.263(a)-3(n)(1) ............................ 20  
      Making the election .................................................................................................................................................. 20  
   Partial disposition election — Treas. Regs. §1.168(i)-8 ............................................................................................ 21  
      Treatment of assets in single- and multiple-asset accounts .................................................................................... 21  
      Making the election .................................................................................................................................................. 22  
      Accounting method changes ........................................................................................................................................ 23  
   Capital expense vs. repair ............................................................................................................................................. 23  
      Unit of property ......................................................................................................................................................... 23  
      Acquisition costs ....................................................................................................................................................... 26  
      Capital expenditures for improvements ................................................................................................................... 28  
      Betterments .............................................................................................................................................................. 28  
      Restorations ............................................................................................................................................................. 30  
      Adaptations to new or different use ............................................................................................................................ 32
Depreciation

Change in accounting method filing options ................................................................. 32
Large taxpayers and non-automatic consent changes .................................................. 32
Small taxpayers with automatic consent changes ....................................................... 33
“Protective” Form 3115 ............................................................................................... 33
Simplified method under Rev. Proc. 2015-20 ............................................................... 34

California depreciation: treatment of repair regulations ............................................ 36
Individuals, partnerships, and S corporations .............................................................. 36
C corporations .............................................................................................................. 36
How California conforms to the federal repair regulations ......................................... 37
Materials and supplies ............................................................................................... 37
Capital expenditures .................................................................................................. 37
Units of property ........................................................................................................ 38
Partial asset dispositions ........................................................................................... 38
When to file Form 3115 with a California return ....................................................... 39
Form 3115 and IRC §481(a) changes ......................................................................... 40
Filing for an accounting change with the FTB ............................................................ 41

California depreciation: relationship to federal law .................................................. 43
Individuals and passthrough entities ......................................................................... 43
Depreciation and amortization provisions ................................................................. 44
C corporations ............................................................................................................ 47
Depreciation calculation method for corporations ..................................................... 47
Straight-line .............................................................................................................. 47
Declining balance ..................................................................................................... 47
Sum-of-the-years digits method ................................................................................ 47
Other consistent methods ....................................................................................... 48
Salvage value ............................................................................................................ 48
Period of depreciation ............................................................................................... 49
Which depreciation methods to use? ......................................................................... 50
Additional first-year depreciation allowance ............................................................. 50

Appendix ...................................................................................................................... 52
Completed Form 3115 — materials and supplies ...................................................... 52
Completed Form 3115 — partial asset dispositions .................................................... 61
Completed Form 3115 — adoption of repair regulations ............................................ 72
INTRODUCTION

In recent years, the IRS has finalized capitalization and repair regulations. These regulations refocus attention on California’s nonconformity to most federal depreciation law — particularly for C corporations.

In this material we will analyze the tangible property capitalization and repair regulations and California’s partial conformity. We will also provide details on California’s depreciation allowances for individuals and corporations.

Note that depreciation for individuals includes partnerships, trusts, and LLCs. We will refer to this as PIT (Personal Income Tax). Depreciation for corporations applies to C corporations only. S corporations follow individual law. We will refer to this as CIT (Corporate Income Tax).

TANGIBLE PROPERTY CAPITALIZATION AND REPAIR REGULATIONS

Over the course of the last several years, the IRS has been working to provide clarity as to what expenditures are capital in nature that must be depreciated over an asset’s class life and what expenditures qualify as repairs that may be currently deducted. This often contentious area of the tax law has resulted in volumes of court cases. The stated goal of the regulations is to reduce such controversy.

RECENT HISTORY

- Proposed regulations issued August 21, 2006 (71 FR 48590), addressed amounts paid to acquire, produce, or improve tangible property;
- Proposed regulations issued March 10, 2008 (73FR 12838), withdrew and replaced the 2006 proposed regulations;
- Temporary regulations issued December 27, 2011 (T.D. 8564; 76 FR 81060), withdrew the 2008 proposed regulations and issued new companion proposed regulations that largely cross-referenced the new temporary regulations. The temporary regulations were to be effective for tax years beginning on or after January 1, 2012; and
- Notice 2012-51 (2012-51 IRB 713) was published on November 20, 2012, changing the effective date of the 2011 temporary regulations to taxable years beginning on or after January 1, 2014. However, taxpayers were permitted to apply the temporary regulations on their original effective date of January 1, 2012.

Then the IRS issued the final Tangible Property Repair (TPR) regulations, on September 19, 2013 (T.D. 9636), and the partial disposition regulations, which were issued on August 14, 2014 (T.D. 9689). (Note: These were prior to the issuance of Rev. Proc. 2015-20, which simplified accounting method change filings. It is discussed beginning on page 34.)

The regulations allow for new “safe harbors” under which taxpayers may elect to treat certain expenses as deductible repairs. These include the following:

- De minimis safe harbor (see page 8);
- Small taxpayer safe harbor (see page 12); and
- Routine maintenance safe harbor (see page 15).
In addition, the rules provide clarity as to what are deductible materials and supplies and provide new rules as to when they may be deducted, depending on whether they are classified as incidental, nonincidental, or as rotatable, temporary spare parts, or standby emergency spare parts (see pages 16–17).

The regulations also allow taxpayers to elect to claim a partial disposition of an asset and recognize loss on the retirement or abandonment of the partial asset rather than having to depreciate both the original and replacement asset (see page 21).

For those taxpayers who simply do not want to be bothered to maintain two separate books and do not want to have to spend the time evaluating whether a capital expense can be treated as a deductible repair expense, an election is available to simply capitalize all expenses that are capitalized for financial book purposes (see page 20).

Finally, the regulations provide extensive guidance as to what acquisition costs must be capitalized (see page 26) and when activities are classified as improvements that must be capitalized (see page 28).

**ACCOUNTING METHOD CHANGES**

Many of these changes require taxpayers to make a change of accounting method to take advantage of the new tax benefits provided. There are 21 automatic accounting method changes and nine different elections allowed under the TPRs. See the charts “Changes in Accounting Method” on pages 4–5 and “Tangible Property Capitalization/Repair Regulations Election Chart” on page 7 for a complete listing of these method changes and elections.

Under IRC §446, a taxpayer cannot change accounting methods from year to year without permission from the IRS. The taxpayer must file Form 3115, Application for Change in Accounting Method, although for the TPRs, small taxpayers may qualify for a simplified method under Rev. Proc. 2015-20 (see page 34). The taxpayer may also have to make an adjustment to prevent amounts of income or expense from being duplicated or omitted. This is called an IRC §481(a) adjustment.

All IRC §481(a) adjustments are aggregated in the year of change. When all IRC §481(a) adjustments produce a decrease in taxable income, it is known as a “net negative §481(a) adjustment.” Conversely, when all IRC §481(a) adjustments produce an increase in taxable income, it is known as a “net positive §481(a) adjustment.” A net negative §481(a) adjustment is taken into account entirely in the year of the change. A net positive §481(a) adjustment is generally taken into account over a period of four years—the year of change and three subsequent years.

Practice Pointer

For several IRC §481(a) adjustments related to the TPRs, only amounts paid or incurred on or after January 1, 2014, are considered. Those items include:

- Materials and supplies;
- De minimis safe harbor amounts;
- Costs for acquisition of real property;
- Inherently facilitative costs; and
- IRC §263A direct and indirect material costs.

There is no time limit on how far back you should review your books and records. A change in accounting method takes into account all differences from the inception of the entity/activity. For practical purposes, the limit on how far to go back will be dictated by the taxpayer’s records.
The IRS frequently issues Revenue Procedures (Rev. Procs.) outlining how taxpayers may receive automatic consent for particular accounting method changes and several of these were issued in relation to the TPRs.

The following Revenue Procedures were issued to address accounting method changes associated with the TPRs:

- **Rev. Proc. 2014-16 (January 2014):** Method changes for amounts paid to acquire, produce, or improve tangible property;
- **Rev. Proc. 2014-17 (February 2014):** Method changes for depreciation;
- **Rev. Proc. 2014-54 (September 2014):** Method changes for depreciation and dispositions; and


The accounting method changes and procedures for the major changes made by the TPRs will be addressed for each change discussed below.

Taxpayers may file for automatic consent on a single Form 3115, even if the taxpayer is making changes in more than area. Rev. Proc. 2015-20 now allows taxpayers to make many of the automatic consent changes directly on the return rather than by filing a Form 3115 (see page 33). The normal scope limitations on changing accounting methods do not apply to a taxpayer making one or more changes for any tax year beginning before January 1, 2015. Scope changes would normally apply if the taxpayer is under examination, is in the final year of a trade or business, or is changing the same accounting method it changed in the previous five years.

### Filing deadlines

Taxpayers not using the simplified method of making accounting method changes to apply the TPRs must file Form 3115 no earlier than the first day of the year of change and no later than the date they file the original Form 3115 with their federal income tax return for the year of change. Calendar year taxpayers applying the regulations to 2014 must file for an automatic change by September 15, 2015 (October 15, 2015, for individual taxpayers).

If a Form 3115 is submitted with the return, a signed copy of the Form 3115 must also be sent to the IRS in Ogden, Utah, in lieu of filing the national office copy. The Ogden, Utah, copy of Form 3115 should be mailed to:

<table>
<thead>
<tr>
<th>Address</th>
</tr>
</thead>
<tbody>
<tr>
<td>Internal Revenue Service</td>
</tr>
<tr>
<td>1973 Rulon White Blvd.</td>
</tr>
<tr>
<td>Mail Stop 4917</td>
</tr>
<tr>
<td>Ogden, UT 84201-1000</td>
</tr>
</tbody>
</table>

On an e-file tax return, Form 3115 can be attached as a PDF.

See page 34 for additional details concerning the Form 3115 filing requirements and for the simplified method available to small taxpayers, which does not require the filing of Form 3115.
There is no Form 3115X to file an amended Form 3115. If a change is necessary on a previously filed Form 3115, correspondence should be sent to the IRS in Ogden, Utah. If a taxpayer is under examination, before an Appeals office, or before a federal court, an additional copy of the correspondence should also be sent to the examining agent, appeals officer, and government counsel on the same date that the information is sent to Utah. See Rev. Proc. 2015-13, Section 6.03(e).

<table>
<thead>
<tr>
<th>Description of change</th>
<th>DCN</th>
<th>Citation</th>
<th>Rev. Proc.</th>
<th>Included in Rev. Proc. 2015-20?</th>
</tr>
</thead>
<tbody>
<tr>
<td>A change to deducting repair and maintenance expenses or to capitalizing (and depreciating if applicable) improvements to tangible property; changes to units of property</td>
<td>184</td>
<td>§§1.162-4, 1.263(a)-3</td>
<td>2014-16</td>
<td>Yes</td>
</tr>
<tr>
<td>Depreciation of leasehold improvements (over MACRS period rather than period of lease)</td>
<td>199</td>
<td>§1.167(a)-4</td>
<td>2014-17, 2014-54</td>
<td>No</td>
</tr>
<tr>
<td>Treatment of removal costs in disposal (entire or partial) of a depreciable asset</td>
<td>21</td>
<td>§1.263(a)-3(g)(2)(i)</td>
<td>2014-16</td>
<td>No</td>
</tr>
<tr>
<td>Permissible to permissible method of accounting for depreciation of MACRS property (single asset accounts to multiple asset accounts, multiple asset account to other multiple asset account, grouping of general asset accounts)</td>
<td>200</td>
<td>§§1.168(i)-1, 1.168(i)-7, and 1.168(i)-8</td>
<td>2014-17, 2014-54</td>
<td>Partial</td>
</tr>
<tr>
<td><strong>Materials and supplies</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Change to deducting nonincidental materials and supplies when used or consumed</td>
<td>186</td>
<td>§1.162-3(a)(1), (c)(1)</td>
<td>2014-16</td>
<td>Yes</td>
</tr>
<tr>
<td>Change to deducting incidental materials and supplies when paid or incurred</td>
<td>187</td>
<td>§1.162-3(a)(2), (c)(1)</td>
<td>2014-16</td>
<td>Yes</td>
</tr>
<tr>
<td>Change to deducting nonincidental, rotatable, and temporary spare parts when disposed of</td>
<td>188</td>
<td>§1.162-3(a)(3), (c)(2)</td>
<td>2014-16</td>
<td>Yes</td>
</tr>
<tr>
<td>Change to the optional method for rotatable and temporary spare parts</td>
<td>189</td>
<td>§1.162-3(e)</td>
<td>2014-16</td>
<td>Yes</td>
</tr>
<tr>
<td><strong>Acquisition — facilitative costs</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Change by a dealer in property to deduct commissions and other transaction costs that facilitate the sale of property</td>
<td>190</td>
<td>§1.263(a)-1(e)(2)</td>
<td>2014-16</td>
<td>Yes</td>
</tr>
<tr>
<td>Change by a nondealer in property to capitalizing commissions and other costs that facilitate the sale of property</td>
<td>191</td>
<td>§1.263(a)-1(e)(1)</td>
<td>2014-16</td>
<td>Yes</td>
</tr>
<tr>
<td>Change to capitalizing acquisition or production costs, and if depreciable, depreciation of such property under §§167 or 168</td>
<td>192</td>
<td>§1.263(a)-2</td>
<td>2014-16</td>
<td>Yes</td>
</tr>
<tr>
<td>Change to deducting certain costs for investigating or pursuing the acquisition of real property</td>
<td>193</td>
<td>§1.263(a)-2(f)(2)(iii)</td>
<td>2014-16</td>
<td>Yes</td>
</tr>
</tbody>
</table>

(continued)
<table>
<thead>
<tr>
<th>Description of change</th>
<th>DCN¹</th>
<th>Citation</th>
<th>Rev. Proc.</th>
<th>Included in Rev. Proc. 2015-20?</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>UNICAP-related changes</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Change to reasonable allocation method under §263A for self-constructed assets</td>
<td>194</td>
<td>§1.263A-1(f)(4)</td>
<td>2014-16</td>
<td>No</td>
</tr>
<tr>
<td>Change to stop capitalizing foreclosure-related acquisition and holding costs</td>
<td>195</td>
<td>§1.263A-3(a)(1)</td>
<td>2014-16</td>
<td>No</td>
</tr>
<tr>
<td><strong>Partial dispositions</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Late partial disposition election (may be made for tax years beginning before January 1, 2015)</td>
<td>196</td>
<td>§1.168(i)-8</td>
<td>2014-17, 2014-54</td>
<td>Yes/No²</td>
</tr>
<tr>
<td>Revocation of a general asset election</td>
<td>197</td>
<td>§1.168(i)-1</td>
<td>2014-17, 2014-54</td>
<td>No</td>
</tr>
<tr>
<td>Partial dispositions of tangible depreciable assets to which the IRS’s adjustments pertain</td>
<td>198</td>
<td>§1.168(i)-8</td>
<td>2014-17, 2014-54</td>
<td>No</td>
</tr>
<tr>
<td>Disposition of a building or structural component, gain or loss recognized</td>
<td>205</td>
<td>§1.168(i)-8</td>
<td>2014-54</td>
<td>Yes</td>
</tr>
<tr>
<td>Dispositions of tangible depreciable assets (other than buildings or structural components), gain or loss recognized</td>
<td>206</td>
<td>§1.168(i)-8</td>
<td>2014-54</td>
<td>Yes</td>
</tr>
<tr>
<td>Dispositions of tangible depreciable assets in a general asset account</td>
<td>207</td>
<td>§1.168(i)-1</td>
<td>2014-54</td>
<td>No</td>
</tr>
<tr>
<td><strong>Miscellaneous</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Change to a regulatory accounting method (only applies to taxpayers subject to regulatory accounting rules by FERC, FCC, and STB)</td>
<td>185</td>
<td>§1.263(a)-3(m)</td>
<td>2014-16</td>
<td>Yes</td>
</tr>
</tbody>
</table>

¹ Designated Automatic Accounting Method Change Number
² If Rev. Proc. 2015-20 followed, no late partial disposition elections allowed
| Section 6.37(3)(a)(i) | Change from single asset accounts for MACRS items to multiple asset accounts (or pools) for same assets, or vice versa | 200 | §1.168(i)-7 |
| Section 6.37(3)(a)(ii) | Change from grouping specific items of MACRS property in multiple asset accounts to a different grouping of same assets in multiple asset accounts | 200 | §1.168(i)-7(c) |
| Section 6.37(3)(a)(iii) | Change to method of identifying assets (or portions of assets) disposed of in multiple asset accounts from specific identification to FIFO or modified FIFO | 200 | §§1.168(i)-8(g)(1), 1.168(i)-8(g)(2), 1.168(i)-8(g)(2)(i), 1.168(i)-8(g)(2)(ii), 1.168(i)-8(g)(2)(iii) |
| Section 6.37(3)(a)(vi) | Change in method of identifying mass assets (or portions of mass assets) disposed of in multiple asset accounts from specific identification to a mortality dispersion table | 200 | §§1.168(i)-8(g)(1), 1.168(i)-8(g)(2)(i), 1.168(i)-8(g)(2)(ii), 1.168(i)-8(g)(2)(iii) |
| Section 6.37(3)(a)(ix) | Multiple asset accounts: When impracticable from TPs records to determine unadjusted depreciable basis of asset disposed of, changing from one reasonable method to another reasonable method | 200 | §1.168(i)-8(f)(2) |
| Section 6.37(3)(a)(x) | Partial dispositions: When impracticable from TPs records to determine unadjusted basis of disposed portion of asset disposed of, changing from one reasonable method to another reasonable method | 200 | §1.168(i)-8(f)(3) |
Table: Tangible Property Capitalization/Repair Regulations Election Chart

<table>
<thead>
<tr>
<th>Election Description</th>
<th>How Election is Made</th>
<th>Treas. Regs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Election to capitalize rotable, temporary, or emergency spare parts</td>
<td>Made by doing it on timely filed (with extensions) original return</td>
<td>§1.162-3(d)</td>
</tr>
<tr>
<td>De minimis safe harbor (follows book expensing policies)</td>
<td>Annual statement on timely filed (with extensions) original return. Irrevocable</td>
<td>§1.263(a)-1(f)</td>
</tr>
<tr>
<td>Election to capitalize employee compensation and/or overhead as facilitating the acquisition of property</td>
<td>Made by doing it on timely filed (with extensions) original return</td>
<td>§1.263(a)-2(f)(2)(iv)</td>
</tr>
<tr>
<td>Election to capitalize otherwise deductible repairs that are capitalized for book</td>
<td>Annual statement on timely filed (with extensions) original return</td>
<td>§1.263(a)-3(n)</td>
</tr>
<tr>
<td>Small taxpayer safe harbor election</td>
<td>Annual statement on timely filed (with extensions) original return</td>
<td>§1.263(a)-3(h)</td>
</tr>
<tr>
<td>Partial disposition election (non-General Asset Account (non-GAA) property)</td>
<td>Made by doing it on timely filed (with extensions) original return</td>
<td>§1.168(i)-8(d)</td>
</tr>
<tr>
<td>General asset account (GAA) election for current-year property placed in service</td>
<td>Check the box on Line 18, Form 4562, Depreciation and Amortization, and include with timely filed (with extensions) original return. Irrevocable</td>
<td>§1.168(i)-1(l)</td>
</tr>
<tr>
<td>Optional termination of a GAA at disposition of all assets, the last asset, or the remaining portion of the last asset in the GAA</td>
<td>Made by doing it on timely filed (with extensions) original return</td>
<td>§1.168(i)-1(e)(3)(ii)</td>
</tr>
<tr>
<td>Optional termination of a qualifying disposition of an asset within a GAA</td>
<td>Made by doing it on timely filed (with extensions) original return</td>
<td>§1.168(i)-1(e)(3)(iii)</td>
</tr>
</tbody>
</table>

WORKING THE REGULATIONS TO THE TAXPAYER’S BENEFIT

The Tax Increase Prevention Act of 2014 (TIPA ’14) retroactively extended both the enhanced IRC §179 election and bonus depreciation through December 31, 2014. Because the extensions are only valid through 2014, many businesses will be in for a shock in 2015 if their IRC §179 deduction is reduced from $500,000 to $25,000 or if they may no longer claim bonus depreciation or the deduction for qualified leased, restaurant, or retail property improvements.

However, many taxpayers may find that the capitalization and repair regulations can work in their favor.

The regulations clarify which expenses qualify as materials and supplies and routine repairs that may be deducted as regular business expenses, and which expenses that might normally qualify as capital expenses may be expensed under new “safe harbors,” as outlined in the chart below.
The final regulations adopt the temporary regulation’s “Unit of Property” standards, making it much clearer when taxpayers may claim deductions when making repairs on building components. The final regulations also adopt the proposed regulations treatment of a partial disposition election, which allows taxpayers to claim losses upon the retirement of a component of a unit of property.

**DE MINIMIS SAFE HARBOR ELECTION — TREAS. REGS. §1.263(a)-1(f)**

Businesses may find some help in the form of the *de minimis* safe harbor introduced in the final capitalization regulations. Many businesses may be able to use this *de minimis* safe harbor election to
expense certain business assets and may even come out ahead because there is no IRC §179 expense limit, placed-in-service limit, or taxable income limit. (Treas. Regs. §1.263(a)-1(f))

In brief, if a taxpayer files a proper election and follows certain rules, the taxpayer may deduct tangible “units of property” with costs up to $500 or $5,000, depending on whether the taxpayer has an “applicable financial statement.”

Comment

The de minimis safe harbor election does not have to be made on a tax return in order for a taxpayer to expense items on their tax return that have acquisition or production costs less than a specified dollar amount. However, without the de minimis safe harbor election, it is possible for the IRS to challenge the expensing of any amounts in an examination. The de minimis safe harbor election protects the treatment of an expenditure as a current year expense for amounts that do not exceed the applicable threshold ($500 or $5000).

Applicable financial statement (AFS)

An “applicable financial statement” is defined in Treas. Regs. §1.263(a)-1(f)(4).

An AFS for purposes of this de minimis safe harbor election is one that has the highest priority among those listed in the regulation. There are three applicable financial statements (listed with the highest priority first):

1. A financial statement required to be filed with the Securities and Exchange Commission (SEC) (the 10-K or the Annual Statement to Shareholders);
2. A certified audited financial statement that is accompanied by the report of an independent certified public accountant (or in the case of a foreign entity, by the report of a similarly qualified independent professional) that is used for:
   a. Credit purposes;
   b. Reporting to shareholders, partners, or similar persons; or
   c. Any other substantial non-tax purpose; or
3. A financial statement (other than a tax return) required to be provided to the federal or a state government or any federal or state agency (other than the SEC or the Internal Revenue Service).

Comment

The definition of an AFS (especially considering #2 above) does not mention the contents of the CPA’s report (i.e. unqualified, qualified or adverse).

Transactional costs such as delivery fees, installation, or similar costs included on the same invoice must be included in the cost of the property.

Safe harbor election rules and amounts

The rules for both taxpayers with and without an AFS are the same with the exception of the dollar amount considered to be de minimis and whether their accounting procedure must be written. Taxpayers with an AFS must have a written accounting procedure in order to utilize the benefits of this de minimis safe harbor.
1. The taxpayer has an accounting procedure treating as an expense for non-tax purposes:
   a. Amounts paid for property costing less than a specific dollar amount; or
   b. Amounts paid for property with an economic useful life of 12 months or less; and

2. The taxpayer treats amounts paid for the property as an expense on its AFS (or on its books if no AFS) in accordance with their accounting procedures; and

3. The amount paid for the property does not exceed $5,000 ($500 without an AFS) per invoice (or per item as substantiated by the invoice).

**Comment**

The IRS is currently accepting comments as to whether the $500 threshold should be increased.
(Rev. Proc. 2015-20)

**Exceptions — Treas. Regs. §1.263(a)-1(f)(2)**

The *de minimis* safe harbor election does not apply to:

- Amounts paid for property that is or is intended to be included in inventory property;
- Amounts paid for land;
- Amounts paid for rotable, temporary, and standby emergency spare parts that the taxpayer elects to capitalize and depreciate under Treas. Regs. §1.162-3(d); and
- Amounts paid for rotable and temporary spare parts that the taxpayer accounts for under the optional method of accounting for rotable parts pursuant to Treas. Regs. §1.162-3(e).

The safe harbor provisions do not apply to IRC §263A costs. However, such expenses may still qualify for the IRC §179 asset expense election.

**Practice Pointer**

The regulation requires the accounting procedure be written for those taxpayers expensing costs up to $5,000. Although those using the $500 limit are not required to have the procedure in writing, it is better to play it safe so there can be no question that such a procedure existed.

Companies that don’t already have accounting procedures in place qualifying them for the *de minimis* safe harbor should consider creating or revising their accounting procedures before the end of the current year to bring their nontax expensing limit in line with the $5,000 or $500 limit.

Reminder: The written procedures must be in place at the start of the tax year.

Accounting procedures are generally part of a company’s overall accounting policies. For clients that do not have adequate (or any) accounting policies, consider providing them with a sample capitalization policy that they can adopt.
Sample capitalization policy

Purpose
This accounting policy establishes the minimum cost (capitalization amount) that shall be used to determine the capital assets to be recorded in [BUSINESS ENTITY]’s books and financial statements.

Capital asset definition and thresholds
A “Capital Asset” is a unit of property with a useful life exceeding one year and a per-unit acquisition cost exceeding [SPECIFY AMOUNT]. Capital assets will be capitalized and depreciated over their useful lives. [BUSINESS ENTITY] will expense the full acquisition cost of tangible personal property below these thresholds in the year purchased.

Capitalization method and procedure
All Capital Assets are recorded at historical cost as of the date acquired.

Tangible assets costing below the aforementioned threshold amount are recorded as an expense for [BUSINESS ENTITY]’s annual financial statements (or books). In addition, assets with an economic useful life of 12 months or less must be expensed for both book and financial reporting purposes.

Documentation
Invoices substantiating the acquisition cost of each unit of property are to be retained for a minimum of 10 years.

Tax capitalization threshold: The permissible ceiling for deducting otherwise capitalizable expenditures is $5,000 when our business has applicable financial statements. The threshold is limited to $500 in the absence of applicable financial statements.

Election
A taxpayer must elect on an annual basis to apply the safe harbor by including a statement on the taxpayer’s timely filed original return (including extensions). (Treas. Regs. §1.263(a)-1(f)(5)) If made, the election applies to all qualifying expenses that meet the requirements; an electing taxpayer cannot exclude particular qualifying expenses. The election automatically extends to materials and supplies.

Practice Pointer
Should a taxpayer not want to expense an item under the de minimis safe harbor, the taxpayer can simply not expense them on the books and records.

The regulations provide that the statement must:

- Be titled “Section 1.263(a)-1(f) de minimis safe harbor election;”
- Include the taxpayer’s name, address, and taxpayer identification number; and
- Include a statement that the taxpayer is making the de minimis safe harbor election under Treas. Regs. §1.263(a)-1(f).

In the case of a consolidated group, the election is made for each member of the group by the common parent, and the statement must include the name and taxpayer identification number of each member of the group.
In the case of a partnership or S corporation, the election is made by the partnership or S corporation and not by the partners or shareholders.

Once made, the election is irrevocable for that year. (Treas. Regs. §1.263(a)-1(f)(5))

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**Example of de minimis election**

Tinyco does not have an applicable financial statement, but has written accounting policies in place at the start of the tax year treating as expenses for financial statement purposes amounts paid for property costing $500 or less.

During the tax year, Tinyco purchases 20 printers costing $300 each, 14 desks costing $250 each, and 30 chairs costing $200 each for a total cost of $15,500. They also purchase 20 laptop computers costing $1,000 each.

If Tinyco makes the *de minimis* election, they may expense the $15,500 for the printers, desks and chairs, and still have their full IRC §179 election amount available to expense the laptop computers.

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**Anti-abuse rule (Treas. Regs. §1.263(a)-1(f)(6))**

Taxpayers who manipulate transactions with the intent to derive a tax benefit or avoid the limitations of the regulation will face recharacterization of the amounts.

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**Example of anti-abuse rule**

Haulit Corporation does not have an applicable financial statement, but has written accounting procedures in place at the start of the year treating as expenses for financial statement purposes amounts paid for property costing $500 or less.

During the tax year, Haulit purchases a used truck for $1,500. Haulit requests the seller to provide multiple invoices for different parts of the truck. The seller provides Haulit with four invoices — one invoice of $500 for the cab, one invoice of $500 for the engine, one invoice of $300 for the trailer, and a fourth invoice of $200 for the tires. Haulit treats the amounts paid under each invoice as an expense on its books and applies the *de minimis* safe harbor to the amounts substantiated by the invoices.

Haulit Corporation has manipulated a transaction by componentizing property that would ordinarily be a single unit of tangible property in order to utilize the *de minimis* safe harbor.

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**Practice Pointer**

No accounting method change is required. (Rev. Proc. 2014-16)

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**SAFE HARBOR FOR SMALL TAXPAYERS WITH BUILDINGS**

The regulations include a maximum $10,000 annual safe-harbor election for qualified small taxpayers with buildings owned or leased with an unadjusted basis no greater than $1 million. (Treas. Regs. §1.263(a)-3(h)) If the taxpayer qualifies and makes the election, the taxpayer is not required to capitalize, and may deduct, qualifying expenditures.
Small taxpayer

To qualify, the taxpayer must have average annual gross receipts of $10 million or less during the three preceding taxable years. Gross receipts include income from sales (not reduced by cost of goods sold), services, and investment income.

For new businesses, average annual gross receipts are determined using the average annual gross receipts for the number of taxable years that the taxpayer (or its predecessor) has been in existence. For short taxable years, the gross receipts are annualized.

Qualified building

An eligible building property includes a portion of a building that is a separate unit of property, such as leased office space or an individual condominium or cooperative unit, as long as the unadjusted basis of the property is no greater than $1 million. Unadjusted basis of the building includes the unadjusted basis of any capitalized improvements made after acquisition.

(Note: Unadjusted basis does not include land value.)

The unadjusted basis for leased property is equal to the total amount of undiscounted rent paid or expected to be paid over the entire lease term, including reasonably expected renewal periods.

Cliff test

Under the safe harbor, a small taxpayer is not required to capitalize improvements if the total amount paid with respect to an eligible building for repairs, maintenance, improvements, and similar activities does not exceed the lesser of $10,000 or 2% of the building’s unadjusted basis.

In computing the amounts expended, the taxpayer must include amounts not capitalized under the de minimis safe harbor election and under the routine maintenance provisions.

If the amount of such expenditures exceeds the threshold, the taxpayer is not eligible to make the election. The threshold is applied separately to each building owned or leased by the taxpayer. A condominium or coop is considered an individual building property.

Making the election

The election is made annually by attaching a statement to the taxpayer’s timely filed (including extensions) original return for the tax year for which the property is placed in service. The statement must be titled “Section 1.263(a)-3(h) Safe Harbor Election for Small Taxpayers” and include the taxpayer’s name, address, taxpayer identification number, and a description of each eligible building property to which the taxpayer is applying the election.

In the case of a partnership or S corporation, the election is made by the partnership or S corporation, and not by the partners or shareholders.

Once made, the annual election is irrevocable.
Example of small taxpayer with building

Jack and Jill own four rental properties just down the hill. Their average annual gross receipts are less than $10 million.

**Property A**

This property has an unadjusted basis of $700,000 in the building and $100,000 in land. They build a new room on the property at a cost of $8,000 and have repair and maintenance costs of $1,000.

The total spent for improvements and maintenance is $9,000.

The threshold amount is $10,000 (lesser of $10,000 or 2% of the building’s unadjusted basis (2% × $700,000 = $14,000)).

They may elect to expense the cost of the new room and the repairs because they otherwise qualify, and the sum of the costs of improvements and maintenance is less than the threshold amount.

**Property B**

This property has an unadjusted basis of $300,000 for the building and $50,000 for the land. They build a spa at the property at a cost of $6,000 and have $500 of general repairs.

The total spent for improvements and maintenance is $6,500.

The threshold amount is $6,000 (lesser of $10,000 or 2% of the building’s unadjusted basis (2% × $300,000 = $6,000)).

They may not elect to expense the cost of the spa because the total cost of improvements and maintenance exceeds the threshold amount. They may deduct the maintenance costs as general repairs.

**Property C**

This property has an unadjusted basis of $800,000 for the building and $50,000 for the land. They build a garage at the property at a cost of $12,000 and have $3,000 of maintenance costs.

The total spent for improvements and maintenance is $15,000.

The threshold amount is $10,000 (lesser of $10,000 or 2% of the building’s unadjusted basis (2% × $800,000 = $16,000)).

They may not elect to expense the cost of the garage because the total cost of improvements and maintenance exceeds the threshold amount. They may deduct the maintenance costs as general repairs.

**Property D**

This property has an unadjusted basis of $1,100,000 for the building and $350,000 for the land. They build a pool at the property at a cost of $9,000 and have $100 of general repairs.

They may not elect to expense the cost of the pool because the building’s unadjusted basis exceeds $1 million.

(Treas. Regs. §1.263(a)-3(h)(10), Ex. 3)
SAFE HARBOR FOR ROUTINE MAINTENANCE —
TREAS. REGS. §1.263(a)-3(i)

The regulations provide that routine maintenance need not be capitalized, including routine maintenance for buildings and their structural components. The final regulations removed the requirement under the temporary regulations that the taxpayer had to treat the maintenance as an expense on its applicable financial statement.

An election is not required to take advantage of the safe harbor.

“Routine”

The regulations specify that maintenance is routine only if:

- The maintenance is performed to keep a unit of property in its ordinarily efficient operating condition and not to improve or better the property; and
- At the time the unit of property is placed in service by the taxpayer, the taxpayer reasonably expects to perform the routine maintenance more than once during the property’s class life (more than once every 10 years in the case of a building).

**Note:** Maintenance does not actually have to be performed within those time frames so long as the taxpayer has a reasonable expectation of such at the time the property is placed in service.

Examples of routine maintenance include inspection, cleaning, testing, and the replacement of parts. It also includes the replacement of damaged or worn parts with comparable and commercially available replacement parts.

**Example of routine maintenance**

A mall contains an escalator system with 40 escalators. When placed in service, the owner reasonably expected to replace the handrails on the escalators every four years to keep the escalator system in its ordinarily efficient operating condition. The escalator system is a part of a building system.

Because the replacement of the handrails must be performed more than once every 10 years, the replacements are within the routine maintenance safe harbor. (Treas. Regs. §1.263(a)-3(i)(6), Ex. 14)

Ineligible expenses

The safe harbor provisions do not apply to IRC §263A costs (costs incurred for production of property, or for resale, i.e., inventory).
In addition, amounts expended for the following are not routine and are not eligible for the safe harbor:

- For the betterment of a unit of property (see page 28);
- For the cost of replacing components if:
  - A retirement loss is claimed; and
  - Gain or loss is realized upon the sale of the replaced component.
- For which a basis adjustment is required on account of a casualty loss or event;
- To restore deteriorated and nonfunctional property to its ordinarily efficient operating condition;
- To adapt property to a new or different use;
- To repair, maintain, or improve network assets such as infrastructure related to railroads, water, power, telephone and cable companies (these costs will be addressed through the Industry Issue Resolution (IIR) program); or
- To repair, maintain, or improve rotable or temporary spare parts that were deducted when first installed.

Practice Pointer

A change in accounting method is required with a full IRC §481(a) adjustment.

MATeRIALS AND SUPPleS — TreAS. REgS. §1.162-3

The final regulations expanded the threshold under which a unit of property is treated as a material or supply that may be expensed from $100 to $200. (Treas. Regs. §1.162-3)

Materials and supplies, which may be deducted rather than capitalized, are defined as property used or consumed in the taxpayer’s trade or business that is not inventory and that is:

- A component required to maintain or repair a unit of property (e.g., tools) used in the business but that is not acquired as a part of a unit of property;
- Fuel, lubricants, and other consumables that are expected to be consumed in 12 months or less;
- A unit of property with an economic useful life of 12 months or less; and
- Any property that meets the de minimis rule.

However, the IRC §263A uniform capitalization rules apply to materials and supplies that are used in the production of inventory, to self-constructed assets, and property acquired for resale. Such items must be capitalized and depreciated rather than deducted.

When to deduct

If an item is considered to be a material or supply, different rules apply as to when the item will be deducted depending on the type of material or supply involved or elections made by the taxpayer.

If the taxpayer makes a de minimis safe harbor election, and the material or supply falls under the expensing amount established in the taxpayer’s accounting policy (e.g., $500 or $5,000), then the item must be deducted in the year it is purchased.

Incidental materials and supplies are deducted in the tax year their cost is paid or incurred. Incidental materials and supplies are items that are carried on hand and for which no record of
consumption is kept or for which no physical inventories are kept at the beginning or end of the taxable year.

Nonincidental materials and supplies that are not included in the de minimis safe harbor or that are not considered rotatable, temporary spare, or standby emergency parts are deducted in the year the item is first used or consumed in the taxpayer’s operations. Standby emergency parts are considered used or consumed when they are installed.

**Rotatable, temporary and standby emergency spare parts**

Rotatable and temporary spare parts are considered to be first used or consumed in the taxable year in which the taxpayer disposes of the parts, unless a taxpayer elects the optional method of accounting.

<table>
<thead>
<tr>
<th>Differences between rotatable, temporary, and standby emergency spare parts</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Rotatable spare parts</strong></td>
</tr>
<tr>
<td>These are materials and supplies that are acquired for installation on a unit of property, removable from that unit of property, generally repaired or improved, and either reinstalled on the same or other property or stored for later installation.</td>
</tr>
<tr>
<td><strong>Temporary spare parts</strong></td>
</tr>
<tr>
<td>These are materials and supplies that are used temporarily until a new or repaired part can be installed and then are removed and stored for later installation.</td>
</tr>
<tr>
<td><strong>Standby emergency spare parts</strong></td>
</tr>
<tr>
<td>The regulations provide 11 distinct criteria to define standby emergency spare parts. Standby emergency spare parts are materials and supplies that are:</td>
</tr>
<tr>
<td>- Acquired when particular machinery or equipment is acquired (or later acquired and set aside for use in particular machinery or equipment);</td>
</tr>
<tr>
<td>- Set aside for use as replacements to avoid substantial operational time loss caused by emergencies due to particular machinery or equipment failure;</td>
</tr>
<tr>
<td>- Located at or near the site of the installed related machinery or equipment so as to be readily available when needed;</td>
</tr>
<tr>
<td>- Directly related to the particular machinery or piece of equipment they serve;</td>
</tr>
<tr>
<td>- Normally expensive;</td>
</tr>
<tr>
<td>- Only available on special order and not readily available from a vendor or manufacturer;</td>
</tr>
<tr>
<td>- Not subject to normal periodic replacement;</td>
</tr>
<tr>
<td>- Not interchangeable in other machines or equipment;</td>
</tr>
<tr>
<td>- Not acquired in quantity (generally only one is on hand for each piece of machinery or equipment); and</td>
</tr>
<tr>
<td>- Not repaired and reused.</td>
</tr>
</tbody>
</table>

The optional method of accounting may be used to deduct the cost of a rotatable and temporary spare part (but not an emergency spare part) when the part is first installed. If this method is used, the part’s FMV must be included in gross income in the year it is removed, and various basis adjustments must be made when the part is removed, repaired or maintained, and reinstalled. The remaining basis is then deducted when the part is disposed. (Treas. Regs. §1.162-3(e)) Due to the complexities of tracking these costs and adjustments it is unlikely this option will be used very often.
Election to capitalize rotatable, temporary, and standby emergency spare parts

Taxpayers may make an annual election to capitalize the cost of any rotatable spare part, temporary spare part, or standby emergency spare part, with certain limited exceptions. The election can be made on an item-by-item basis. No separate statement is required to be attached to the return. The taxpayer simply treats the item as a depreciable capital item on its timely filed original return, including extensions, in the year the item is placed in service.

This election may be revoked with the consent of the Commissioner.

Example of materials and supplies

A remote luxury resort offers a variety of excursions for its residents. The resort has private planes and small boats to transport residents and also provides each resident with a golf cart to drive around the resort grounds.

To maintain this transportation fleet, the resort purchases the following items:

- Oil and other lubricants;
- A variety of rotatable spare tires, batteries, and other small engine parts that are purchased in Year 1, used on a temporary basis in Years 2 and 3, and disposed of in Year 4;
- An emergency standby boat engine; and
- Several radio control operating systems, valued at $3,000 each.

The resort may account for these purchases as follows:

- Deduct the oil and other lubricants in the year purchased because they are consumables with an economic useful life of less than 12 months;
- Deduct the rotatable spare parts in Year 4 because that is the year the parts were disposed of, and the taxpayer did not choose to use the optional method of accounting;
- Capitalize and depreciate the emergency standby boat engine, because the taxpayer made an election to capitalize the cost of the engine; and
- If the resort has an applicable financial statement for the year and a $5,000 per item expensing policy, the radio control operating systems can be deducted by using the de minimis safe harbor election.

Accounting method changes

Compliance with the final regulations relating to materials and supplies requires a change in method of accounting. (Treas. Regs. §1.162-3(i))

Under Rev. Proc. 2014-16, the following methods are “paid or incurred” methods that require the calculation of a modified IRC §481(a) adjustment:

- Change to deducting the cost of nonincidental materials and supplies to the year used or consumed (change 186);
- Change to deducting the cost of incidental materials and supplies to the year paid or incurred (change 187); and
- Change to deducting the cost of nonincidental rotatable and temporary spare parts to the year disposed of (change 188).
For purposes of applying the final TPRs, the modified IRC §481(a) adjustment is calculated taking into account only amounts paid or incurred in taxable years beginning on or after January 1, 2014. However, the optional accounting method for rotable and temporary spare parts (change 189) requires the computation of a full IRC §481(a) adjustment.

Note: The election to capitalize and depreciate rotable, temporary, and standby emergency spare parts is not an accounting method change. (Treas. Regs. §1.162-3(d)(3))

Completing Form 3115

Accounting method changes to comply with the final TPRs regarding materials and supplies, repair and maintenance costs, and unit of property definitions are automatic changes that do not require the consent of the Commissioner. Additionally, qualifying taxpayers have a reduced filing requirement. A qualifying taxpayer is one with average annual gross receipts for the three preceding taxable years of $10 million or less.

Qualifying taxpayers need only complete the following information on Form 3115:

- The identification section of page 1 (above Part I);
- The signature section at the bottom of page 1;
- Part I, line 1(a);
- Part II, all lines except lines 11, 13, 14, 15, and 17;
- Part II, line 13, if the change is to depreciating property;
- Part IV, lines 25 and 26; and
- Schedule E, if applicable.

Multiple automatic changes to comply with the final TPRs can be made on the same Form 3115. Alternatively, qualified taxpayers may use the Rev. Proc. 2015-20 simplified reporting method discussed on page 34.

Example of automatic changes under Rev. Proc. 2014-16

Mattie Rials is a sole proprietress who owns a gardening service with average annual gross receipts of less than $10 million. Prior to 2014, she purchased various edgers, weed whackers, mowers, and blowers, each with a cost of less than $200. Mattie capitalized the cost of these gardening tools in the year they were purchased, waiting to expense the costs when each tool was first placed in service. In 2014, Mattie begins to follow the tangible property regulations that treat each of these gardening tools as incidental materials and supplies which may be deducted in the year purchased. At the end of 2013, capitalized garden tools that have not been placed in service have a cost of $4,000.

Mattie has a change of accounting method to deducting incidental materials and supplies in the year in which they are purchased. (Designated Change Number 187, Treas. Regs. §1.162-3(a)(2)) The amount of Mattie’s IRC §481(a) adjustment is $4,000.

A completed copy of Form 3115 for Mattie Rials is in the Appendix, on page 52.
ELECTION TO CAPITALIZE REPAIR AND MAINTENANCE EXPENDITURES — TREAS. REGS. §1.263(a)-3(n)(1)

Taxpayers wanting to reduce the administrative burden of maintaining two separate accounting systems may elect to treat repair and maintenance expenditures as depreciable capital expenditures as long as:

- The expenses are incurred in the taxpayer’s trade or business; and
- The expenses are capitalized on the taxpayer’s books and records.

If an election is made, all repair and maintenance expenditures capitalized in the taxpayer’s books and records for the taxable year must be capitalized for tax purposes as well. So it is important to evaluate a taxpayer’s capitalization policies to see if it is worth the “cost” of foregoing the routine maintenance or de minimis safe harbors for the administrative and compliance advantages of the book-conformity election. But remember, those expenses that are not capitalized on the taxpayer’s books may still qualify for the de minimis safe harbor, the safe harbor for small taxpayers with buildings, or the routine maintenance safe harbor.

Costs must be capitalized at the time the property is placed in service.

Comment

This is a “one-way” election. If the book-conformity election is made it does not mean that all items that are expensed on the taxpayer’s books can automatically be expensed for tax purposes. These items must still be evaluated under the other TPRs to see if they qualify to be expensed for tax purposes.

Note: This book-conformity election applies only to repair and maintenance costs deductible under Treas. Regs. §1.162-4. It does not apply to costs incurred for material and supplies or other costs deducted under other code sections.

Making the election

The election is made annually by attaching a statement to the taxpayer’s timely filed (including extensions) original return for the tax year for which the property is placed in service. The statement must be titled “Section 1.263(a)-3(n) Election” and include the taxpayer’s name, address, taxpayer identification number, and a statement that the taxpayer is making an election to capitalize repair and maintenance costs under Treas. Regs. §1.263(a)-3(n).

In the case of a partnership or S corporation, the election is made by the partnership or S corporation, and not by the partners or shareholders.

In the case of a consolidated group, the election is made for each member of the group by the common parent, and the statement must include the name and taxpayer identification number of each member of the group.

Practice Pointer

No accounting method change is required. (Rev. Proc. 2014-16)
PARTIAL DISPOSITION ELECTION — TREAS. REGS. §1.168(i)-8

Under the partial disposition election rules, taxpayers may elect to recognize gain or loss on the retirement, replacement, or other disposition of a partial asset (such as a roof on a building), rather than leaving a “stranded basis” on the books, as was required prior to the issuance of the temporary repair regulations in 2011.

Under the pre-2012 rules, taxpayers who replaced a portion of a capital asset were required to continue to depreciate the remaining basis of the property that was replaced as well as depreciate the replacement property (e.g., both roofs in the example above).

When the temporary regulations were released, the partial disposition election was only available for those assets that were placed in a general asset account (GAA). However the proposed and final regulations allow the election for assets placed in single or multiple asset accounts but dramatically limited the availability of this election for those taxpayers who had the assets in GAAs.

As discussed in more detail below, as a result of these changes, Rev. Procs. 2014-17 and 2014-54 allow taxpayers to make late partial disposition elections and change of accounting methods to take advantage of the opportunities provided by the final partial disposition rules.

Treatment of assets in single- and multiple-asset accounts

Under the general disposition rules, a gain or loss is recognized on the sale, exchange, abandonment, or conversion of an entire asset.

For purposes of the partial disposition rules, the asset is:

- Each building, including its structural components;
- Each condominium or co-op in a building;
- Each item listed in one of the asset classes 00.11 through 00.4 of Rev. Proc. 87-56 or properly classified under IRC §168(e)(3); and
- Improvements or additions to assets.

A disposition also includes a disposition of a portion of an asset as a result of a:

- Casualty (IRC §165);
- Gain deferral under an IRC §1031 like-kind exchange or IRC §1033 involuntary conversion;
- Transfer in a step-in-the-shoes transaction described in IRC §168(i)(7)(B); and
- Sale of a portion of an asset.

Consequently, a taxpayer must recognize gain or loss on the item “disposed” and must capitalize the cost of replacing the asset. No election is required.

Treas. Regs. §1.168(i)-8 allows taxpayers to elect to claim a gain/loss on the partial disposition of an asset held in a single-asset account or multiple-asset account, without having identified the component as an asset before the disposition event. (Special rules apply to partial dispositions concerning GAAs (Treas. Regs. §1.168(i)-1), but as most small and medium size businesses are unlikely to use these accounts, we will not address these in this report.)

Practice Pointer

Although a taxpayer may elect to claim a loss on the retirement or abandonment of a partial asset disposition, because a taxpayer is required to capitalize, rather than expense, the replacement asset and associated replacement costs, taxpayers should weigh which option would be more tax beneficial.
Example of replacement of partial asset

An apartment building owner needs to replace a bathroom sink in one of the building’s 25 apartments. Consider the following options.

Assume that the original cost of the sink when purchased in January 2012 was $500, and the taxpayer depreciates using the straight-line method over the class life of 27.5 years. In January 2015, the taxpayer replaces the sink with a new sink that costs $750. The labor cost to replace the sink is an additional $250.

If a partial disposition election is made, the taxpayer would claim the following deductions related to the sink for the 2015 tax year:

- Unadjusted basis of the retired sink: $433
- Depreciation deduction for new sink: $34
- Total deductions: $467

If a partial disposition election is not made, and the taxpayer continues to depreciate the original sink but expenses the cost of the new sink and labor costs, the taxpayer may claim the following on his 2015 return:

- Depreciation deduction for retired sink: $16.67
- Repair expenses (materials and labor): $1,000.00
- Total deductions: $1,016.67

Making the election

The election is made by:

- Reporting the gain, loss, or other deduction on the taxpayer's timely filed (including extensions) original federal tax return for the tax year of the disposition of the portion of the asset (no election statement is required); and
- If the asset is properly included in one of the asset classes 00.11 through 00.4 of Rev. Proc. 87-56, by classifying the replacement portion of the asset under the same asset class as the disposed portion of the asset in the tax year in which the replacement portion is placed in service by the taxpayer.

Asset classes 00.11 through 00.4 describe various types of assets that are generally used in all business activities, such as office furniture, fixtures, and equipment; information systems (including computers); vehicles, such as cars, trucks, and buses; vessels; land improvements; and industrial steam and electric generation/or distribution systems.

This election may not be made or revoked by the filing of an application for a change in method of accounting.

To revoke a partial disposition election, a taxpayer must file a request for a letter ruling and obtain the consent of the IRS. The election may be revoked by obtaining a letter ruling from the IRS if the taxpayer acted reasonably and in good faith, and the revocation will not prejudice the interests of the government.

A partial disposition election may also be made if the IRS disallows a taxpayer's repair deduction for the amount paid or incurred for the replacement of a portion of an asset and requires that the amounts be capitalized. In this case, the election is made by applying for a change in accounting method (DCN 198), but only if the asset of which the disposed portion was a part is owned by the taxpayer at the beginning of the year of change.
Cost segregation studies are not mandatory for determining the basis of an asset disposed of in a partial disposition. Rules for determining the partial asset’s basis are in Treas. Regs. §1.168(i)-8(f). These regulations indicate that taxpayers may use any reasonable method for determining basis. Examples given in the regulations include:

- Discounting the cost of the replacement asset by the Producer Price Index for Finished Goods or the Producer Price Index for Final Demand;
- Using a pro rata allocation of the unadjusted depreciable basis of the asset replaced; or
- A study allocating the cost of the asset to its individual components.

**Accounting method changes**

Rev. Procs. 2014-17 and 2014-54 outline the required accounting method changes for partial dispositions and changes in the asset groupings (e.g., single asset, multiple asset, and general asset accounts). Unless the taxpayer uses Rev. Proc. 2015-20’s simplified method, Form 3115 is required to be filed for the following:

- Late partial disposition election (change 196);
- Revocation of a general asset account election (change 197);
- Partial dispositions of tangible depreciation assets after IRS adjustment (change 198);
- Change in method of accounting for MACRS (single, multiple, or general asset account) (change 200);
- Disposition of a building or structural component, gain or loss recognized (change 205);
- Disposition of a tangible personal property depreciable asset, gain or loss recognized (change 206);
- Disposition of tangible depreciable assets in a general asset account (change 207).

A sample Form 3115 for partial dispositions is in the Appendix, on page 61.

**CAPITAL EXPENSE VS. REPAIR**

Under IRC §263, amounts paid to acquire, produce, or improve tangible property must be capitalized and depreciated. However, under IRC §162, expenses for materials and supplies and repair and maintenance costs are treated as a deductible business expense. The TPRs were adopted to clarify which is which, especially as it relates to clarifying what is a “deductible repair” and what is a “capital improvement” that must be depreciated.

The TPRs do not impact any other IRC provisions, such as IRC §263A, which requires taxpayers to capitalize the direct and allocable indirect costs to property produced by the taxpayer and property acquired for resale. Similarly, IRC §195 requires taxpayers to capitalize certain start-up expenditures. If these rules apply, the associated costs must continue to be capitalized (unless the small taxpayer safe harbor rules apply.

**Unit of property**

Whether costs are classified as deductible repairs or a capital improvement frequently turns on the size of the property worked on. The larger the unit of property, the more likely the work involved will be classified as a repair. Consequently, determining what exactly is the “unit of property” can have significant consequences.
Practice Pointer

Property that is aggregated or subject to a general asset account election or pooled in a multiple asset account may not be treated as a single unit of property. Therefore it would not make sense to place items that might incur significant repair costs in a GAA or multiple asset account.

Different rules apply for determining what a “unit of property” is, depending upon what type of property is involved. (Treas. Regs. §1.263(a)-3(e))

Buildings (including leased buildings)

The unit of property for buildings is the building structure and each of the following nine building systems:

- Heating, ventilation, and air conditioning systems (HVAC) (including motors compressors, boilers, furnaces, chillers, pipes, ducts and radiators);
- Plumbing systems (including pipes, drains, valves, sinks, bathtubs, toilets, water and sanitary sewer collection equipment, and site utility equipment);
- Electrical systems (including wiring, outlets, junction boxes, lighting fixtures, and site utility equipment used to distribute electricity from the property line to and between buildings and other permanent structures);
- All escalators;
- All elevators;
- Fire protection and alarm systems (including sensing devices, computer controls, sprinkler heads, sprinkler mains, associated piping or plumbing, pumps, alarms, alarm control panels, heat and smoke detection devices, fire escapes, fire doors, emergency exit lighting and signage, and fire-fighting equipment such as extinguishers and hoses);
- Security systems (including window and door locks, security cameras, recorders, monitors, motion detectors, security lighting, alarm systems, entry and access systems, related junction boxes, associated wiring, and conduit);
- Gas distribution system (including associated pipes and equipment used to distribute gas to and from the property line and between buildings or permanent structures); and
- Other structural components when identified in guidance published in the Federal Register or the Internal Revenue Bulletin.

Comment

Treating different building systems as individual units of property is a significant departure from the pre-TPR rules, which treated a building and all its systems as a single unit of property. But note that the definitions of a building and of building systems as separate units of property are used to determine whether or not costs should be capitalized or currently deducted. Absent a cost segregation study, a new building will be set up on a depreciation schedule as a single asset (separate from its land cost).

Lessees who rent only a portion of a building apply the same rules, but only to those system components within their leased space.
**Example of improvement to leased office space**

A Plus Accounting Company leases an office space within a 10-story building. As part of its lease terms, it is responsible for maintenance and upkeep of its leased space, including the individual HVAC system contained within its space. The HVAC system breaks down and needs to be replaced. A Plus must capitalize the expense of the HVAC system as it is a “unit of property,” and the replacement would be considered an improvement.

Had the landlord been responsible for replacing the individual HVAC unit in the leased space, it would likely have been considered a repair as it would have only involved one of dozens of HVACS found in the building, and all the HVACS in the building would constitute a single unit of property.

**Personal and other real property**

The unit of property for personal and other real property, other than plant property, is all components that are functionally interdependent. Components are functionally interdependent if the placing in service of one component by the taxpayer is dependent on the placing in service of the other component.

**Example of functional interdependence**

A sales company provides cars to all of its salesmen. An alternator needs to be replaced in one of the cars. The unit of property would be the car, rather than the alternator, because the car cannot be placed in service without the alternator.

**Caution**

Despite the rules above, components depreciated under separate class lives or different depreciation methods are treated as separate units of property.

Property that is comprised of different components that, at the time the property is placed in service, have different class lives or depreciation methods must be divided into separate units of property.

For example, if a purchaser of a truck tractor treats the tractor tires as five-year property and the tractor as three-year property at the time the tractor is purchased, then the tires and the truck must be treated as separate units of property.

Similar rules apply for property for which a different depreciation method is used in subsequent tax years. For example, if a building owner makes leasehold improvements to a portion of the building and treated the leasehold improvements as 15-year property under IRC §168(e), then the leasehold improvements must be treated as a separate unit of property than the rest of the building which is depreciated over 39 years.

**Plant property**

The functionally interdependence test is further broken down for purposes of determining the unit of property for plant property. For plant property the unit of property is a component that performs a discrete and major function or operation within the functionally interdependent machinery or equipment. So each piece of equipment involved in an assembly line process would be considered a “unit of property” even though all the machines are functionally interdependent in terms of producing the end product.
Example of plant property — discrete and major function

Fluffit Company operates a uniform and linen rental business. Fluffit has a plant that utilizes multiple pieces of equipment in an assembly line-like process to treat, launder, and prepare rental items for its customers.

Fluffit utilizes two laundering lines in its plant, each of which can operate independently. One line is used for uniforms and the other line is used for linens. Both lines incorporate a sorter, boiler, washer, dryer, ironer, folder, and waste water treatment system.

Because the laundering equipment contained within the plant is property other than a building, the unit of property for the laundering equipment is initially determined to be comprised of all the components that are functionally interdependent. Under this rule, the initial units of property are each laundering line because each line is functionally independent and is comprised of components that are functionally interdependent.

However, because each line is comprised of plant property, Fluffit must further divide these initial units of property into smaller units of property by determining the components that perform discrete and major functions within the line. Fluffit must treat each sorter, boiler, washer, dryer, ironer, folder, and waste water treatment system in each line as a separate unit of property because each of these components performs a discrete and major function within the line.

Network assets

The unit of property for network assets (infrastructure related to railroad, water, power, telephone, and cable companies) will be addressed in future IRS published guidelines.

Change of accounting method

Unless the taxpayer qualifies for the Rev. Proc. 2015-20 simplified method discussed on page 34, a Form 3115 must be filed and an IRC §481(a) adjustment made if there is a change of accounting method as a result of a change:

- To identifying the unit(s) of property, or
- In the case of a building, identifying the building structure or building systems, or
- To removal costs of assets or components of a unit of property not disposed of (see below) (change 184).

Acquisition costs

Amounts paid to acquire or produce a unit of real or personal property (other than deductible materials and supplies, as discussed above) must be capitalized. (Treas. Regs. §1.263(a)-2(d)) The costs that must be capitalized include:

- Invoice price;
- Transaction/facilitative costs (see discussion below);
- Costs for work performed prior to putting the unit of property in service (e.g., installation costs, pre-tests, etc.); and
- Costs to defend or perfect title, such as attorneys fees to contest a condemnation, challenge a zoning ordinance, or the establishment of a building line. (Treas. Regs. §1.263(a)-2(e))
Facilitative costs

Unless expensed under the *de minimis* safe harbor, amounts paid to facilitate the acquisition of real or personal property must be capitalized. (Treas. Regs. §1.263(a)-2(f)) These include amounts paid in the process of investigating or otherwise pursuing the acquisition.

Inherently facilitative costs include the following:

- Transportation costs such as shipping and handling fees;
- Appraisal costs;
- Negotiating the acquisition’s terms or structure and obtaining tax advice on the acquisition;
- Application fees, bidding costs, or similar expenses;
- Preparing and reviewing the acquisition documents such as the bid, offer, sales contract, and purchase agreement;
- Examining and evaluating the property’s title;
- Obtaining regulatory approval of the acquisition or securing related permits and paying application fees;
- Conveying property between the parties, including sales and transfer taxes, and title registration costs;
- Finders’ fees or brokers’ commissions, including contingency fees;
- Architectural, geological, survey, engineering, environmental, or inspection services related to particular properties; and
- Services provided by a qualified intermediary or other facilitator of an IRC §1031 exchange.

Employee compensation and overhead costs are not included in the facilitative costs unless a taxpayer makes an election to include either or both costs. The election is made separately for each acquisition and does not require a separate statement. Rather, the taxpayer simply treats the amounts to which the election applies as acquisition costs on a timely filed original federal return, including extensions. A change of accounting method is not required, and the election may only be revoked with the consent of the Commissioner.

Inherently facilitative costs allocable to property not acquired are capital expenditures related to such property, and, with the exception of contingency fees, may be allocated to those properties and recovered (e.g., as a loss under IRC §165 or depreciated under IRC §167 or §168).

**Comment**

An amount paid by a taxpayer in the process of investigating or otherwise pursuing the acquisition of real property does not have to be capitalized (unless it is inherently facilitative) if it relates to activities performed in the process of determining whether to acquire real property and which real property to acquire.

For example, amounts paid to a development consulting firm to perform market surveys, evaluate zoning and environmental requirements, and to make preliminary reports and recommendations as to where a business should locate a store are not considered facilitative costs.

**Change of accounting method**

Unless the taxpayer qualifies for the Rev. Proc. 2015-20 simplified method discussed on page 34, a Form 3115 must be filed and an IRC §481(a) adjustment made if there is a change of accounting method as a result of capitalizing these acquisition costs (changes 190–193).
Capital expenditures for improvements

Costs must be capitalized if they are paid or incurred for:

- A betterment to a unit of property;
- A restoration of the unit of property; or
- Adaptation of the unit of property to a new or different use.

(Treas. Regs. §1.263(a)-3(d))

A taxpayer must capitalize all the direct costs of an improvement and all the indirect costs, including otherwise deductible repair costs that directly benefit or are incurred by reason of an improvement. However, indirect costs performed at the same time that the improvement is made do not have to be capitalized if they do not directly benefit and are not incurred by reason of an improvement. (Treas. Regs. §1.263(a)-3(g)(1))

For example, a trucking company is required to capitalize the cost of painting a new logo on the cab of a truck that is replaced (and capitalized), but it is not required to capitalize the replacement of a cracked tail light that is performed at the same time.

However, removal costs incurred in disposing of a depreciable asset (including partial disposals) for which a gain or loss is recognized are not required to be capitalized. If the asset is disposed of, but it is not recognized as a disposition for federal tax purposes, then the taxpayer may either deduct or capitalize the removal costs, depending on whether the removal costs are incurred by reason of a repair or of an improvement. (Treas. Regs. §1.263(a)-3(g)(2))

Change of accounting method

Unless the taxpayer qualifies for the Rev. Proc. 2015-20 simplified method discussed on page 34, per Rev. Proc. 2014-16, a taxpayer may need to file a Form 3115 to reflect a change of accounting method (e.g., depreciation to expense deduction or vice versa) (change 184).

Betterments

Amounts paid for a betterment to a unit of property must be capitalized. (Treas. Regs. §1.263-3(j))

A betterment consists of:

- The amelioration of a pre-existing material condition or defect, whether or not known at the time of acquisition;
- The amelioration of a material condition or defect that arose during the production of a unit of property, whether or not known at the time of production;
- A material addition (either in space or capacity); or
- A material increase in the productivity, efficiency, strength, quality, or output of the unit of property (or an activity that one would reasonably expect would result in the foregoing outcomes).

A betterment does not include:

- Repairs undertaken due to normal wear and tear;
- The replacement of a part that is no longer reasonably available with the same type of “new and enhanced” part as a result of technological advancements or product enhancements; and
- Repairs undertaken to comply with city codes, health regulations, etc.
Example of betterments

Examples of betterments that must be capitalized include:

- Soil remediation undertaken on property purchased in the previous year that contained leaking underground gasoline storage tanks that the owner did not discover until after the property was purchased;
- Extensive repairs and maintenance (e.g., repairing damaged drywall, rewallpapering, replacing windows and doors, etc.) undertaken on a recently purchased assisted living facility to bring it into compliance with the purchasing company’s operating standards;
- Expansion bolts added to anchor a building to its cement foundation as part of a business’s efforts to comply with a recently enacted municipal earthquake retrofitting ordinance (Note: This is considered a betterment because it materially increased the strength of the building, not because it was undertaken to comply with the city’s new safety requirements.); and
- Replacement of all of a building’s insulation to reduce the building’s energy costs by 50%.

In contrast, the following are examples of activities that are not considered betterments:

- The replacement of asbestos insulation that was deteriorating and might cause potential health risks with new insulation that is safer for employees but is not more efficient or effective than the asbestos insulation;
- Routine maintenance performed on a used machine fairly soon after a taxpayer purchases the machine from the original owner (Note: This does not qualify for the routine maintenance safe harbor because the maintenance was required primarily from the property’s use by the former owner);
- A retail store’s costs incurred to “refresh” the look and layout of the store is considered routine maintenance, rather than a betterment. Examples of refreshment activities include:
  - Replacing and reconfiguring display cases and racks for better exposure;
  - Making corresponding lighting relocations and flooring repairs;
  - Repainting with a new color scheme to coordinate with new signage; and
  - Moving one wall to accommodate the table and rack reconfiguration.

However, if the work is truly extensive and rises to the level of a major remodel, this would be considered a betterment. Examples would be building expansion and/or electrical upgrades;

- Replacement of two out of 10 roof-mounted HVAC units that will provide a 10% increase in energy efficiency; and
- Replacement of a roof membrane.
Restorations

Amounts paid to restore a unit of property must be capitalized. This includes an amount paid to make good the exhaustion for which an allowance is or has been made. (Treas. Regs. §1.263-3(k)) The following are restorations that must be capitalized:

- The replacement of property for which the taxpayer has properly deducted a loss (other than a casualty loss);
- The replacement of property for which the taxpayer realized gain or loss on its sale or exchange (Note: It is not a restoration if the property had been fully depreciated and the loss was attributable only to the property’s remaining salvage value computed for federal income tax purposes);
- A restoration resulting from damage to the property for which a taxpayer takes a basis adjustment as a result of a casualty loss or relating to a casualty event (see below);
- Returning the property to its ordinarily efficient operating condition after it has fallen into disrepair and functional obsolescence;
- Rebuilding property to a like-new condition after the end of its class life (Note: This does not include costs paid for a comprehensive maintenance program.); or
- Replacement of a part or parts that comprise(s) a major component or a substantial structural part of the property. A major component is a part or combination of parts (other than an incidental component such as a power switch) that performs a discrete and critical function in the operation of the unit of property.

Casualty-related restorations

If a taxpayer reduces the basis of the damaged property following a casualty event, costs incurred to restore the damage must be capitalized at least to the extent of the basis adjustment. Restoration costs in excess of the casualty-related basis adjustments may be deducted if the expenses qualify as repair expenses, but must be capitalized if the costs relate to a betterment, restoration, or adaption of the property to a new or different use.

Example of casualty-related restoration

A company’s office floors were severely damaged when the fire sprinkler system went off. The company received $50,000 in insurance compensation, so it did not take a casualty loss, but did make a $50,000 basis adjustment. After it replaced the flooring, it decided to repaint the walls and replace some of the lighting fixtures. The repainting and electrical work was done purely for cosmetic reasons and cost the company an additional $20,000.

The company must capitalize and depreciate the $50,000 cost to replace the flooring, but may deduct the $20,000 in painting and electrical work.

However, if the company decided to reconfigure its floor plan and moved offices, completely remodeled its bathrooms, and replaced its HVAC systems, this would constitute a betterment, and the associated costs must be capitalized.
Examples of restorations

Replacement of a loss component: The cost of a manufacturer’s walk-in freezer replacement components must be capitalized if:

- The taxpayer claimed a loss due to the abandonment of the original components; or
- The taxpayer sold the original components, if he claimed a loss on the sale.

Replacement of a major component: The replacement of a chiller unit in an HVAC system for a large building must be capitalized because, as the cooling mechanism for the entire system, it performs a discrete and critical function of the HVAC system and is therefore a major component. Conversely, the replacement of one furnace in an HVAC system comprised of three furnaces, three air conditioning units, and duct work is not a significant portion of the major component (three furnaces) of the HVAC system, and therefore does not have to be capitalized. Similarly, the replacement of all the wiring in a building’s electrical system is a capitalizable replacement of a major component, but the replacement of only 30% of the wiring system is not.

If a major remodeling plan encompasses a period of years, the amounts must be capitalized, even though in one year, only a portion (and therefore not a significant amount) of the major components (e.g., bathrooms and plumbing fixtures in a hotel) are remodeled in any one year.

The replacement of an entire roof must be capitalized. When a roof replacement encompasses replacing rotted decking, insulation, asphalt, and coatings, it is a restoration that must be capitalized. A roof performs a discrete and critical function in a building structure. Additionally, because a roof comprises a large portion of the building structure, it is considered a major component of the building structure.

Replacement of an item for which a partial disposition election is made: A taxpayer that replaces one of four elevators in its building is not required to capitalize the replacement because it is not considered a replacement of a significant portion of a major component. However, if the taxpayer makes a partial disposition election and recognizes a loss on the disposition, the taxpayer must treat the amount paid to replace the elevator as a restoration and must capitalize the amount paid.

In contrast, the following are examples of activities that are not considered restorations:

Rebuild of property to like-new condition before end of class life: A short-line railroad owns freight cars that have a recovery period of seven years and a class life of 14 years. Ten years after placing a freight car in service, the taxpayer rebuilds it to the manufacturer’s original specifications. This includes complete disassembly, inspection, reconditioning, or replacement of components of the suspension and draft systems, hitches, and other special equipment. Components are upgraded to the latest engineering standards. The entire car is stripped to the frame and all substantial components are reconditioned or replaced. New wheels are installed. Because all of the work to rebuild the freight car occurs before the end of its class life, none of the cost is required to be capitalized. If the same work were completed more than 14 years after the freight car was placed in service, the entire cost of the rebuild would be capitalized.

(continued)
Examples of restorations (continued)

Not a major component or substantial structural part: A large building has 300 exterior windows that cover 25% of the building surface. Replacing 100 of the windows that have become damaged (without plans to replace others in the near future) does not require capitalization. The windows are considered a major component of the building structure, but the regulations do not consider one-third to be a significant portion. (Treas. Regs. §1.263-3(k)(7) Example 25) However, the cost of replacing 200 of the 300 windows must be capitalized, as the regulations consider two-thirds to be significant.

(Treas. Regs. §1.263-3(k)(7), Ex. 26)

Adaptations to new or different use

Amounts paid to adapt a unit of property to a new or different use must be capitalized. In general, an amount is paid to adapt a unit of property to a new or different use if the adaptation is not consistent with the taxpayer’s ordinary use of the unit of property at the time originally placed in service by the taxpayer. (Treas. Regs. §1.263-3(l)) The question as to whether a taxpayer’s activities amount to a new or different use tends to be fairly fact specific.

In the case of buildings, capitalization is required when a building structure or any of the building systems is adapted to a new or different use.

Examples of adaptations

Change in building use: The conversion of a manufacturing plant to a showroom would amount to a new or different use, and the associated costs would be required to be capitalized.

However, a retail building owner that reconfigures space to accommodate a new retail tenant would not be undergoing an improvement that constitutes a new and different use, nor would preparing the building for sale.

New or different use: A manufacturer closes its plant due to contamination on the land and remediates the contamination to prepare the land for residential development. The remediation work merely returns the land to its pre-contamination condition and is not an adaptation, regardless of the extent to which the land was cleaned. However, re-grading of the land to prepare it for residential development would amount to adapting the land to a new or different use, and therefore the associated costs must be capitalized.

New or different use for part of a building: Reconfiguring part of a pharmacy to an outpatient medical clinic is adapting it to a new or different use, but a grocery store that has a deli and other take-out food counters that reconfigures the space to add a sushi bar is not adapting the store to a new or different use.

CHANGE IN ACCOUNTING METHOD FILING OPTIONS

Large taxpayers and non-automatic consent changes

For taxpayers with average annual gross receipts for the three preceding years in excess of $10 million, a complete Form 3115 must be prepared and filed with their income tax return for tax years beginning on or after January 1, 2014 (unless the taxpayer qualifies for the Rev. Proc. 2015-20 simplified method discussed below).
Small taxpayers with automatic consent changes

For taxpayers with average annual gross receipts for the three preceding years of $10 million or less, reduced filing requirements apply. Generally, the information required when the reduced filing requirements apply is: biographical information, DCNs, a description of the change(s) being made, a calculation of the IRC §481(a) adjustment, and information about depreciation (if applicable). See page 19 for details of which items must be completed for qualifying taxpayers. These taxpayers may also qualify for the Rev. Proc. 2015-20 simplified method as well.

Practice Pointer

Unless there is a common entity filing a tax return, each individual owner is required to file their own Form 3115 for any change in accounting method. This applies to tenants in common as well.

Form 3115 instructions indicate that a separate Form 3115 is required for each separate and distinct trade or business activity. For a taxpayer who is reporting income on both Schedules C and E, each of which has one or more accounting method changes, a separate form 3115 will be required for each schedule.

“Protective” Form 3115

Taxpayers may file a “protective” Form 3115, listing as many DCNs as apply. A “protective” Form 3115 allows a taxpayer to adopt any new methods of accounting under the TPRs that are automatic consent changes. A description of each change that the taxpayer is making is required to be disclosed. A citation to the appropriate paragraph of the Treasury Regulation(s) is also required. An IRC §481(a) adjustment (if any) may be included and the calculation must be described in attachment to Form 3115.

The advantages of filing a “protective” Form 3115 include:

• Compliance with the current tax regulations;
• Ability to use partial disposition election for buildings and other property;
• Ability to write off assets that were capitalized in prior years and could have been expensed;
• Ability to make proper determinations of which expenditures should be capitalized and which should be current deductions; and
• Audit protection under §8.01 of Rev. Proc. 2015-13 for taxable years beginning prior to January 1, 2014.

A sample “protective” Form 3115 is included in the Appendix at page 72.

Practice Pointer

A single Form 3115 should be filed for any of the automatic consent changes covered by tangible property regulations for the following items: repairs and maintenance, materials and supplies, capital expenditures, amounts paid to acquire or produce tangible property, and amounts paid to improve tangible property. (Rev. Proc. 2015-14, Section 10.11)

A separate Form 3115 should be filed for any of the automatic consent changes covered by the MACRS property disposition rules (including partial dispositions). However, all automatic consent changes covered by the MACRS property disposition rules (including partial dispositions) should be included on a single Form 3115. (Rev. Proc. 2015-14, Section 6.38(9))
Simplified method under Rev. Proc. 2015-20

Qualifying small taxpayers may use a simplified method of making accounting method changes to be in conformity with the tangible property regulations without filing Form 3115 or any other separate statement or election with their tax return (although the elections listed on page 7 still require separate election statements to be filed).

Qualifying small taxpayer

A qualifying small taxpayer under this Revenue Procedure is a taxpayer with one or more separate and distinct trade(s) or business(es) that have:

- Total assets of less than $10 million on the first day of the taxable year for which the accounting method change is effective; or
- Average annual gross receipts of $10 million or less for the prior three years.

A taxpayer with more than one trade or business will apply the $10 million threshold test above to each separate and distinct trade or business. See Treas. Regs. §1.263(a)-3(h)(3). It is therefore possible for a single taxpayer to have a tax return with more than $10 million in assets and more than $10 million in gross receipts for the last three years, and still be considered a qualifying small taxpayer.

The Revenue Procedure does not specify how assets are to be counted: tax basis, book basis, or fair market value. According to FAQs issued by the IRS, total assets are determined by the accounting method you regularly use in keeping the books and records of your trade or business at the end of the taxable year. (http://www.irs.gov/Businesses/Small-Businesses-&-Self-Employed/Tangible-Property-Final-Regulations#SimplifiedProceduresforSmallBusinessTaxpayers) For the gross receipts threshold, gross receipts is defined as the “taxpayer’s receipts for the taxable year that are properly recognized under the taxpayer’s methods of accounting used for federal income tax purposes for the taxable year.” (Treas. Regs. §1.263(a)-3(h)(3)(iv))

Under the simplified method, qualifying small taxpayers are permitted to make required tangible property regulation changes without the necessity of filing Form 3115 or having to attach an election statement. Any IRC §481(a) adjustment resulting from the adoption of the regulations is applied on a prospective basis with regard only to those amounts paid or incurred, or dispositions occurring, in tax years beginning on or after January 1, 2014. In general, the taxpayer takes account of changes through the cutoff method.

IRC §481(a) vs. cutoff

The classic case of an accounting method change is a change from the cash basis to the accrual basis. Assume the taxpayer is on a calendar year and the change begins in Year 2. In December of Year 1, the taxpayer incurs an expense of $100 which the taxpayer doesn’t pay until January of Year 2. Because the taxpayer is on the cash basis in Year 1 and doesn’t pay the expense in Year 1, the taxpayer cannot deduct it that year. Because the taxpayer is on the accrual basis in Year 2 and the expense was not accrued in Year 2, the taxpayer cannot deduct it that year, either. Thus, without a remedial provision, the taxpayer never gets to deduct the $100 expense.

Generally, the matter is resolved using an IRC §481(a) adjustment in which the taxpayer brings all pre-change items into compliance with the new method at the time the new method goes into effect. In some cases, however, the cutoff method is used. (Treas. Regs. §1.446-1(e)(2)(ii)(d)(5)(iii)) Under the cutoff method, pre-change items are treated as if still under the pre-change method in post-change years. Therefore, under the cutoff method, the $100 of expense incurred pre-change is treated as being on the cash basis even after the taxpayer is on the accrual basis. Thus, it is deductible when paid in January of Year 2.
Drawbacks to using simplified method

When using the simplified method, taxpayers:

- Cannot make any late partial asset disposition elections;
- Cannot write off assets that were capitalized in prior years that would be expensed under the current regulations; and
- Do not receive audit protection under §8.01 of Rev. Proc. 2015-13 for taxable years beginning prior to January 1, 2014.

Example of prior-year capitalization

Bigco Partnership owns a large office building as its only asset. In 2011, it replaced 100 of the 400 windows in the building at a cost of $100,000. It capitalized the windows and began depreciating them over 39 years.

Under the new regulations, it could have expensed the windows. Accordingly, it can expense the adjusted basis of the windows entirely in 2014 by an IRC §481(a) adjustment. However, to do so it must file Form 3115.

If Bigco uses the simplified method, it must continue to depreciate the windows.

Impact on TPR elections

Using the simplified method does not impact elective provisions of the tangible property regulations. Accordingly, the following elections can be made in conjunction with the simplified method:

- The de minimis safe harbor election (Treas. Regs. §1.263(a)-1(f));
- The safe harbor for small taxpayers with small buildings (Treas. Regs. §1.263(a)-3(h)); and
- The election to capitalize repair and maintenance costs. (Treas. Regs. §1.263(a)-3(n))

Transition Rule

Any taxpayer that files an income tax return for his or her first taxable year beginning on or after January 1, 2014, and includes Form 3115, may withdraw the Form 3115 and any IRC §481(a) adjustment in order to utilize to the simplified method. This can only be accomplished by filing an amended tax return on or before the due date of the taxpayer’s federal income tax return (including extensions) for the year of change.

Effective Dates

All provisions of the final tangible property regulations are effective for tax years beginning on or after January 1, 2014, or to amounts paid or incurred beginning on or after January 1, 2014. For taxpayers who filed a change of accounting method to conform to the 2011 temporary regulations on returns beginning on or after January 1, 2012, and before January 1, 2014, it is not necessary to file an additional change of accounting method unless the method adopted is no longer available in the final regulations.
Comment

With the dramatic, and frequently contradictory, changes in the area of repair versus capitalization, the IRS issued a memorandum on March 15, 2012, to employees in the Large Business and International Division regarding the examination of capitalization issues. (LB&I-4-0312-004) In this directive, the IRS instructed field examiners auditing tax years beginning before January 1, 2012, to discontinue examinations of the specified repair versus capitalization issues and not to begin any new examination activity with respect to those issues.

The IRS updated the directive on March 22, 2013. (LB&I-04-0313-001) This updated directive to the LB&I division reiterated the position to discontinue examinations of specified repair versus capitalization issues for tax years beginning before January 1, 2012. In addition, for examinations of tax years beginning on or after January 1, 2012, and before January 1, 2014, the directive instructed examiners to perform a risk assessment for taxpayers who had already filed a Form 3115, Application for Change in Accounting Method. If no Form 3115 had been filed for the period when taxpayers could elect to change their accounting method, the issue should not be examined.

These two memos are directed only at the Large Business and International Division and are specifically annotated as not being “an official pronouncements of law, and cannot be used, cited, or relied upon as such.” The clear intent of the memos is to curtail the examination activity of repair versus capitalization issue during the period of time where taxpayers had multiple choices of how to apply capitalization policies in their businesses.

CALIFORNIA DEPRECIATION: TREATMENT OF REPAIR REGULATIONS

California’s treatment of the repair regulations, like many other issues, is not straightforward. Whether California conforms to the new repair regulations depends on the type of entity involved and the asset. If California conforms to the underlying federal code section, California will conform to the repair regulation. However, if California does not conform to the underlying federal law, California does not conform to the IRS regulations.

INDIVIDUALS, PARTNERSHIPS, AND S CORPORATIONS

For personal income tax purposes (individuals, partnerships, and LLCs taxed as partnerships) and for S corporations, California generally conforms to the IRC §162 business expense deduction for repairs, IRC §168 MACRS depreciation, and IRC §263 pertaining to capital expenditures. (R&TC §§17201, 17250, 17260) So, to that extent, California would conform to these regulations.

C CORPORATIONS

For C corporations, California:
- Conforms to the IRC §162 business expense deduction for repairs (R&TC §24343);
- Does not conform to MACRS and never conformed to ACRS (R&TC §24349); and
- Conforms to IRC §263 (see page 37).
A corporation must depreciate their capital assets using the pre-1981 year Class Life ADR rules, whereby taxpayers may choose to use a straight-line, declining balance, or sum-of-the-years digits method to depreciate the costs over the useful life of the property (described in more detail below, see page 47).

### HOW CALIFORNIA CONFORMS TO THE FEDERAL REPAIR REGULATIONS

Under California law, when applying the Internal Revenue Code for purposes of the Personal Income Tax Law (PIT) and the Corporate Income Tax Law (CIT), Treasury final and temporary regulations are followed by California to the extent that they do not conflict with California PIT or CIT or with FTB regulations. (R&TC §§17024.5(d), 23051.5(d))

However, the fact that California does not directly incorporate an IRC provision does not mean that California does not follow the federal treatment pertaining to that provision. In a 1942 decision, a California court of appeal stated that:

“The provisions of our statute applicable to the present problem were copied from the federal statute. Under such circumstances the federal decisions constitute not only argumentative authority, but are conclusive on the proper interpretation of our statute.” (*Meanly v. McColgan* (1942) 49 Cal.App.2d 313)

How does this apply to the repair regulations? The answer: “It depends on the regulation.” The tangible property repair regulations (TPRs) are broken down into three primary areas:

- Treatment of materials and supplies;
- Capital expenditures; and
- Partial asset dispositions.

### MATERIALS AND SUPPLIES

California directly incorporates IRC §162 under both CIT and PIT, so California will follow the TPRs as they relate to materials and supplies. (R&TC §§17201, 24343)

### CAPITAL EXPENDITURES

California PIT incorporates IRC §263, so it will follow the Treas. Regs. §1.263(a)-3 provisions listed below. (R&TC §17201)

California CIT does not directly incorporate IRC §263 governing capital expenditures. However, R&TC §24422 replicates the meat of IRC §263(a), the provision that is at the heart of the TPRs.

It is clear that in general California law governing capital expenditures was simply copied from the federal statute and there have been no state regulations or rulings issued that provide a different interpretation for California purposes.

Since 1942, the FTB has made numerous pronouncements affirming its reliance on federal law in areas where California law mirrors federal law. In FTB Notice 89-277, the FTB stated:

“Where the provisions of the Personal Income Tax Law and the Bank and Corporation Tax Law are in substantial conformity with the Internal Revenue Code, the Franchise Tax Board will generally follow federal regulations, procedures, and rulings. However, federal rulings and procedures will not be binding on the Franchise Tax Board for California purposes if an authorized
officer or employee of the Franchise Tax Board has publicly indicated in writing that the ruling or procedure will not be followed.”

This position has been reaffirmed in a 2002 Technical Advice Memorandum and a 2009 FTB Notice, and has been cited in numerous summary and letter decisions issued by the Board of Equalization as well. (FTB Technical Advice Memorandum 2002-0353; FTB Notice 2009-8; Appeal of Dorfler (July 24, 2009) Cal. St. Bd. of Equal., No. 306426; Appeal of Tipton (February 4, 2008) Cal. St. Bd. of Equal., No. 427078)

The FTB has indicated that it will not be releasing any formal statement on the TPRs, so taxpayers should be able to rely on the Treas. Regs. §1.263(a) provisions. These include the TPRs addressing the following:

1. The de minimis safe harbor election (Treas. Regs. §1.263(a)-1(f));
2. The small taxpayers with small building safe harbor election (Treas. Regs. §1.263(a)-3(h));
3. The routine maintenance safe harbor (Treas. Regs. §1.263(a)-3(i));
4. The book-tax conformity election (Treas. Regs. §1.263(a)-3(m));
5. The provisions governing betterments, adaptations, and restorations (Treas. Regs. §1.263(a)-3); and
6. Facilitation and acquisition costs (Treas. Regs. §1.263(a)-1, 2).

When to file a separate California election

If a taxpayer is making the same election for California as for federal purposes, a copy of the election is not required to be sent to the FTB. If the taxpayer makes a separate election for California, a “California only” copy of the election must be prepared and sent to the FTB along with the California return. (R&TC §17024.5(e), 23051.5(e))

Units of property

California also conforms to the unit of property provisions under Treas. Regs. 1.263(a)-3(e). (R&TC §§17201, 24422)

Although California does not conform to the MACRS class life for CIT and modifies it for PIT, we feel that California will still follow the federal unit of property determination. Because there is no clear answer to this question, we have requested confirmation from the FTB. We will let you know when we hear more.

PARTIAL ASSET DISPOSITIONS

Under Treas. Regs. §1.168(i)-8, taxpayers may elect to recognize gain or loss on the retirement, replacement, or other disposition of a partial asset (such as a roof on a building), rather than leaving a “stranded basis” on the books, as was required prior to the issuance of the temporary repair regulations in 2011. In instances involving casualty losses, gain deferrals, transfer in a step-in-the-shoes transaction, and sales of a portion of an asset, the partial disposition treatment is required.

California’s depreciation deduction for individuals, estates and trusts, partnerships, and S corporations generally follows federal law, so these taxpayers may follow the new federal treatment of partial asset dispositions. (R&TC §§17201, 17250) In contrast to the classification of capital expenditures, California’s corporate income tax (CIT) treatment of depreciation does not conform to federal law. (R&TC §24349) California does not conform to MACRS and never conformed to ACRS.

However, the FTB has stated that they will be following the partial asset disposition rules for corporate taxpayers because the rules do not conflict with the CIT. But California will not fully
conform because taxpayers must still use California asset classes and useful lives for purposes of determining the depreciation amount, so the actual depreciation deduction will likely be different. (Tax News, FTB, March 2015)

A separate California election is allowed. However, if a casualty loss, gain deferral, step-in-the-shoes transaction, or sale of a portion of an asset is claimed on the California return for the partial asset, a partial asset disposition is required.

### Example of partial asset disposition

Premium Properties, Inc. (PPI) owns commercial rental property, including a small apartment building in San Francisco. In 2014, it replaced six of the 10 HVAC units in the building at a cost of $500,000 and will make a partial asset disposition election under Treas. Reg. §1.168(i)-(8) on the federal return. If PPI does not make the partial asset disposition election, it would be required to continue to depreciate the HVAC units that were replaced as well as the replacement HVAC units.

The original cost of the six HVAC units that were replaced was $120,000 ($20,000 each), with a salvage value of $500 each. PPI has had the property for 10 years.

For federal purposes, PPI has been using the straight-line method and is required to depreciate the units over a 27.5 year period. To date, PPI has depreciated $43,455, leaving a basis of $76,545.

For California purposes, PPI uses the 200% declining balance method over a 40-year period. To date, PPI has depreciated $47,994, leaving a basis of $72,006.

PPI elects to make a partial asset disposition by making the following adjustments on the federal and state return.

<table>
<thead>
<tr>
<th>Partial asset disposition</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Disposed Property</strong></td>
</tr>
<tr>
<td><strong>Federal</strong></td>
</tr>
<tr>
<td>Claim loss of $76,545</td>
</tr>
<tr>
<td><strong>California</strong></td>
</tr>
<tr>
<td>Claim loss of $72,006</td>
</tr>
</tbody>
</table>

### WHEN TO FILE FORM 3115 WITH A CALIFORNIA RETURN

Whether a Form 3115 is required to be attached to the federal return is dependent on which return is being filed. However, when a federal return is required to be attached to the California return, Form 3115 will be included.

If the taxpayer makes a different request for accounting method change for California, a “California only” copy of Form 3115 must be prepared and sent it to the FTB. This might apply in situations in which a taxpayer would want to deduct an expense it had previously capitalized under.
the former regulation for California, but not for federal purposes. (See “Filing for an accounting change with the FTB” on page 41.)

<table>
<thead>
<tr>
<th></th>
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</tr>
</thead>
<tbody>
<tr>
<td>100</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>100S</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>540</td>
<td>No</td>
<td>No, unless otherwise required to file federal return</td>
</tr>
<tr>
<td>541</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>565</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>568</td>
<td>No</td>
<td>No</td>
</tr>
</tbody>
</table>

**FORM 3115 AND IRC §481(A) CHANGES**

As we all know, the big nightmare around the TPRs has centered on whether Form 3115 and an IRC §481(a) adjustment are required. Although Rev. Proc. 2015-20 has provided major relief for the vast majority of taxpayers, IRC §481(a) adjustments may still have to be made on some small taxpayers’ returns, even if they are not required to file a Form 3115. The next question is whether California will simply conform to these changes as well.

Both California PIT and CIT generally conform to the federal accounting change method provisions. (R&TC §§17551, 24651)

In FTB Notice 2000-8, the FTB stated that if a taxpayer submits a request to change an accounting period or method for federal tax purposes and the IRS approves the request (including automatic consent), the change will apply for California purposes without any action by the taxpayer, as long as:

- California has conformed to the underlying law which is being applied;
- The authority for granting the request is within the FTB’s authority; and
- The FTB has not announced that it will not follow the federal procedure being relied upon.

Requests submitted to the IRS for a change to an accounting period or method that is not permitted under California law will not be allowed for California tax purposes.

As discussed above, California PIT and CIT conforms to the materials and supplies and capitalization rules, so it will also follow the applicable automatic consent procedures. This applies whether the adjustment is made (1) directly on the return using either Rev. Proc. 2015-20’s simplified method or (2) on a Form 3115. Federal consent will also constitute California consent.

**Note:** If a different IRC §481(a) adjustment is required as a result of a different depreciation deduction claimed on the California return, this does not constitute a different accounting method change. In such instances, taxpayers should attach to their California tax return both a copy of the federal Form 3115 as well as a pro forma Form 3115 with the numbers adjusted for California.
Example of different depreciation amounts

Smallco, a C corporation that owns a 25-unit apartment building, makes an IRC §481(a) adjustment on its Form 3115 to deduct expenses on its 2014 federal return related to repairs on its building’s plumbing system that it had previously capitalized. Although Smallco may be able to deduct its expenses on its California 2014 tax return as well, the amount of the depreciation deduction it had previously claimed on its California return is different than that claimed on its federal return. Smallco would attach a copy of its federal Form 3115 to its California return, but would modify its §481(a) adjustment on its California return to account for the different depreciation amounts claimed.

Filing for an accounting change with the FTB

Taxpayers that choose to make a different accounting method change on their California return must complete and submit a federal Form 3115 using the California computations to the FTB by the due date for their California returns.

A cover letter must be attached to the front of the federal Form 3115, clearly indicating that a “Change in Accounting Period” is being requested. The name of the taxpayer requesting the change and the taxpayer’s California Corporate Number must be included in the cover letter.

The form and cover letter should be sent to:

Address
Franchise Tax Board
Change in Accounting Periods and Methods Coordinator
P.O. Box 1998
Sacramento, CA 95812
### California Treatment of Key Federal Repair Regulations

<table>
<thead>
<tr>
<th>Federal repair regulation</th>
<th>California personal income tax and S corporation treatment</th>
<th>California corporate income tax treatment</th>
</tr>
</thead>
</table>
| Materials and supplies (Treas. Regs. §1.162-3): Specifies when taxpayers may expense:  
  - Incidental materials and supplies;  
  - Nonincidental material and supplies; and  
  - Spare, rotatable, and stand-by parts | Follows. (R&TC §17201) Separate election to capitalize rather than expense spare, rotatable, and stand-by parts allowed. (R&TC §17024.5(e)) | Follows. (R&TC §24343) Separate election to capitalize rather than expense spare, rotatable, and stand-by parts allowed (R&TC §23051.5(e)) |
| Improvements (Treas. Regs. §1.263(a)-3): Requires improvements to be capitalized on a per “unit of property” basis. Capitalization required for:  
  - Betterments;  
  - Restorations; and  
  - Adaptations to new use | Follows. (R&TC §17201) | Follows. (R&TC §24422) |
| Safe harbor election for small taxpayers with buildings | Follows. (R&TC §17201) Separate California election allowed (R&TC §17024.5(e)) | Follows. (R&TC §24422) Separate California election allowed (R&TC §23051.5(e)) |
| Election to capitalize safe harbor (Treas. Regs. §1.263(a)-3(n)) | Follows. (R&TC §17201) Separate California election allowed. (R&TC §17024.5(e)) | Follows. (R&TC §24422) Separate California election allowed. (R&TC §23051.5(e)) |
| De minimis safe harbor (Treas. Regs. §1.263(a)-2) | Follows. (R&TC §17201) Separate California election allowed. (R&TC §17024.5(e)) | Follows. (R&TC §24422) Separate California election allowed. (R&TC §23051.5(e)) |
| Routine maintenance safe harbor (Treas. Regs. §1.263(a)-3(i)) | Follows. (R&TC §17201) | Follows. (R&TC §24422) |
| Partial asset disposition (Treas. Regs. §1.168(i)-8) | Follows. (R&TC §17201, 17250) | Follows (FTB Tax News, March 2015) |
CALIFORNIA DEPRECIATION: RELATIONSHIP TO FEDERAL LAW

California generally conforms to federal rules regarding depreciation, amortization, and depletion for personal income tax purposes, with numerous exceptions. California does not conform to federal depreciation rules for California corporation tax purposes (applicable to C corporations only).

INDIVIDUALS AND PASSTHROUGH ENTITIES

California follows federal MACRS depreciation, with modifications, for individuals, partnerships, and S corporations. (R&TC §§17201, 17250)

However, even though California follows the MACRS recovery periods, differences between federal depreciation deductions may arise due to different basis (stemming from different expensing provisions, credits, etc.), recovery periods for nonresidential real property, and other special provisions, as outlined below.

In addition, for federal purposes, the recovery period for nonresidential real property is 39 years. California conformed to this provision on January 1, 1997. The California recovery period of 31.5 years should be used for property placed in service on or after May 13, 1993, and before January 1, 1997. (R&TC §§17250, 24349)

Federal law generally requires a 10-year recovery period for fruit-bearing vines for purposes of accelerated cost recovery and a 20-year recovery period for those vines under an alternative depreciation system. California law allows five- and 10-year recovery periods, respectively. (R&TC §§17250(a)(2), 24349(c))

Other differences concerning depreciation and expensing deductions are highlighted in the “Depreciation and Amortization Provisions” chart below.

California’s depreciation deduction is computed on Form 3885, Depreciation and Amortization Adjustments.
## Depreciation and Amortization Provisions

<table>
<thead>
<tr>
<th>IRC §</th>
<th>Deduction item</th>
<th>PIT conformity/treatment</th>
<th>R&amp;TC §</th>
<th>CIT conformity/treatment</th>
<th>R&amp;TC §</th>
</tr>
</thead>
<tbody>
<tr>
<td>167</td>
<td>Depreciation</td>
<td>Partial conformity.</td>
<td>17201, 17250.5</td>
<td>Partial conformity.</td>
<td>24349–24355.4; 24368.1</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Incorporates IRC §167, however, California:</td>
<td></td>
<td>Reasonable allowance for exhaustion, wear and tear for property used in trade or business or held for production of income.</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Modifies the federal income forecast method provisions (allowing distribution costs to be taken into account in depreciation deduction, and prohibiting the expensing of participations and residuals); and</td>
<td></td>
<td>Incorporates:</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Does not follow the federal two-year amortization period for geological and geophysical expenditures (such expenses may be included in depletion deduction or loss deduction allowed in cases of abandonment)</td>
<td></td>
<td>• Modified income forecast method (§167(g));</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>• Cost recovery periods for computer software, purchased mortgage servicing rights, and service and supply contracts; and</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>• Federal disallowance of depreciation and amortization deduction for certain property term interests</td>
<td></td>
</tr>
<tr>
<td>168</td>
<td>MACRS</td>
<td>Partial conformity.</td>
<td>17201, 17250</td>
<td>Does not conform.</td>
<td>24349</td>
</tr>
<tr>
<td></td>
<td></td>
<td>California does not incorporate:</td>
<td></td>
<td>Generally follows the pre-1980 federal Class Life Asset Depreciation Range (ADR) for property used in a trade or business or held for the production of income</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Shortened recovery periods of Indian reservation property;</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>• 15-year recovery period for qualified leasehold, restaurant and retail improvement property; and</td>
<td></td>
<td></td>
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</tr>
<tr>
<td></td>
<td></td>
<td>• Special allowances for second generation biofuel plant property, reuse and recycling property, and disaster assistance property</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>168(k)</td>
<td>Bonus depreciation (property must be placed in service prior to 2015)</td>
<td>Does not conform</td>
<td>17024.5, 17201, 17250</td>
<td>Does not conform.</td>
<td>24356</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>In lieu of IRC §179 deduction, allows an additional 20% first-year depreciation deduction on personal property with useful life of six years or more. Limited to $10,000 of property additions each year (see p. 44)</td>
<td></td>
</tr>
<tr>
<td>169</td>
<td>Amortization of pollution control facilities</td>
<td>Partial conformity. Limited to California facilities</td>
<td>17201</td>
<td>Partial conformity. Limited to California facilities</td>
<td>24372.3</td>
</tr>
</tbody>
</table>

(continued)
<table>
<thead>
<tr>
<th>IRC §</th>
<th>Deduction item</th>
<th>PIT conformity/treatment</th>
<th>R&amp;TC §</th>
<th>CIT conformity/treatment</th>
<th>R&amp;TC §</th>
</tr>
</thead>
<tbody>
<tr>
<td>173</td>
<td>Expensing of circulation expenditures</td>
<td>Conforms</td>
<td>17201</td>
<td>Conforms</td>
<td>24364</td>
</tr>
<tr>
<td>174</td>
<td>Expensing of research and experimental expenditures</td>
<td>Conforms</td>
<td>17201</td>
<td>Conforms</td>
<td>24365</td>
</tr>
<tr>
<td>175</td>
<td>Expensing of farmer’s soil/water conservation expenditures</td>
<td>Conforms</td>
<td>17201</td>
<td>Conforms</td>
<td>24369</td>
</tr>
<tr>
<td>178</td>
<td>Amortization of lease acquisition costs</td>
<td>Conforms</td>
<td>17201</td>
<td>Conforms</td>
<td>24373</td>
</tr>
<tr>
<td>179</td>
<td>Asset expense election</td>
<td>Partial conformity</td>
<td></td>
<td>Partial conformity</td>
<td>24356</td>
</tr>
<tr>
<td></td>
<td>California’s deduction:</td>
<td></td>
<td></td>
<td>California’s deduction:</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Limited to $25,000 per year;</td>
<td></td>
<td></td>
<td>• Limited to $25,000 per year;</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Phase-out threshold is $200,000;</td>
<td></td>
<td></td>
<td>• Phase-out threshold is $200,000;</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Not available for off-the-shelf computer software;</td>
<td></td>
<td></td>
<td>• Not available for off-the-shelf computer software;</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Not available for qualified real property improvements; and</td>
<td></td>
<td></td>
<td>• Not available for qualified real property improvements; and</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Election modification must receive FTB approval</td>
<td></td>
<td></td>
<td>• Election modification must receive FTB approval</td>
<td></td>
</tr>
<tr>
<td>179B</td>
<td>Expensing of EPA sulfur regulation compliance costs</td>
<td>No conformity.</td>
<td>17201.4</td>
<td>No conformity.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Costs must be depreciated</td>
<td></td>
<td></td>
<td>Costs must be depreciated</td>
<td></td>
</tr>
<tr>
<td>179C</td>
<td>Expensing of qualified refinery property</td>
<td>No conformity.</td>
<td>17257</td>
<td>No conformity.</td>
<td>179C</td>
</tr>
<tr>
<td></td>
<td>Costs must be depreciated</td>
<td></td>
<td></td>
<td>Costs must be depreciated</td>
<td></td>
</tr>
<tr>
<td>179D</td>
<td>Expensing of energy efficient commercial buildings (applies to buildings placed in service prior to 2015)</td>
<td>No conformity.</td>
<td>17257.2</td>
<td>No conformity.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Costs must be depreciated</td>
<td></td>
<td></td>
<td>Costs must be depreciated</td>
<td></td>
</tr>
<tr>
<td>IRC §</td>
<td>Deduction item</td>
<td>PIT conformity/treatment</td>
<td>R&amp;TC §</td>
<td>CIT conformity/treatment</td>
<td>R&amp;TC §</td>
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</tr>
<tr>
<td>179E</td>
<td>Expensing of mine safety equipment (applies to buildings placed in service prior to 2015)</td>
<td>No conformity. Costs must be depreciated</td>
<td>17257.4</td>
<td>No conformity. Costs must be depreciated</td>
<td></td>
</tr>
<tr>
<td>180</td>
<td>Expensing of farmer’s soil enrichment materials</td>
<td>Conforms</td>
<td>17201</td>
<td>Conforms</td>
<td>24377</td>
</tr>
<tr>
<td>181</td>
<td>Expensing of qualified film and television production costs</td>
<td>No conformity. Costs must be depreciated.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>17201.5</td>
<td>No conformity. Costs must be depreciated.</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td><strong>Note:</strong> California does have a film credit</td>
<td></td>
</tr>
<tr>
<td>194</td>
<td>Expensing of reforestation expenses</td>
<td>Partial conformity. Deduction limited to California timber property</td>
<td>17278.5</td>
<td>Partial conformity. Deduction limited to California timber property</td>
<td>24372.5</td>
</tr>
<tr>
<td>195</td>
<td>Start-up expenditures</td>
<td>Conforms</td>
<td>17201</td>
<td>Conforms</td>
<td>24414</td>
</tr>
<tr>
<td>197</td>
<td>Amortization of goodwill</td>
<td>Conforms</td>
<td>17201, 17279</td>
<td>Conforms</td>
<td>24355.5</td>
</tr>
<tr>
<td>198A</td>
<td>Expensing of qualified disaster expenses</td>
<td>No conformity. Costs must be depreciated</td>
<td>17279.6</td>
<td>No conformity. Costs must be depreciated</td>
<td></td>
</tr>
<tr>
<td>248</td>
<td>Expensing of corporate organizational expenses</td>
<td>N/A</td>
<td></td>
<td>Conforms</td>
<td>24407–24409</td>
</tr>
<tr>
<td>280F</td>
<td>Luxury auto depreciation and listed property limitation</td>
<td>Conformity. However, California, but not federal law, treats cell phones as listed property</td>
<td></td>
<td>Partial conformity. California corporate depreciation deduction applies and recovery period is the ADR period allowed under California corporate tax law. Cell phones are not treated as listed property</td>
<td>24349.1</td>
</tr>
<tr>
<td>709</td>
<td>Expensing of partnership organizational expenses</td>
<td>Conformity</td>
<td>17851</td>
<td>N/A</td>
<td></td>
</tr>
</tbody>
</table>
C CORPORATIONS

The depreciation deduction for C corporations generally follows the pre-1980 federal Class Life Asset Depreciation Range (ADR) for property used in a trade or business or held for the production of income. (R&TC §24349) Under ADR, assets are prescribed a “useful life” based on the nature or use of the asset. Taxpayers may use their choice of several methods of depreciating assets, including straight-line, declining balance, and sum-of-the-years digits over the course of the useful life of the property, with an allowance for “salvage value.”

DEPRECIATION CALCULATION METHOD FOR CORPORATIONS

Taxpayers may choose between the following methods:

**Straight-line**

The straight-line method divides the cost or other basis of property, less its estimated salvage value, into equal amounts over the estimated useful life of the property. An asset may not be depreciated below a reasonable salvage value.

So if an asset was purchased for $1,100 dollars, and has a $100 salvage value and a useful life of four years, the depreciation deduction would be equal to $250 for each of those years.

The straight-line method must be used for assets with a useful life of less than three years. (R&TC §24350; 18 Cal. Code Regs. §24349(k)(3)(A)(i))

**Declining balance**

Under this method, depreciation is greatest in the first year and smaller in each succeeding year. The property must have a useful life of at least three years. Salvage value is not taken into account in determining the basis of the property, but the property may not be depreciated below a reasonable salvage value.

The amount of depreciation for each year is subtracted from the basis of the property, and a uniform rate of up to 200% of the straight-line rate is applied to the remaining balance. For example, the annual depreciation allowances for property with an original basis of $100,000 are:

<table>
<thead>
<tr>
<th>Year</th>
<th>Remaining Basis</th>
<th>Declining Balance Rate</th>
<th>Depreciation Allowance</th>
</tr>
</thead>
<tbody>
<tr>
<td>First</td>
<td>$100,000</td>
<td>20%</td>
<td>$20,000</td>
</tr>
<tr>
<td>Second</td>
<td>$80,000</td>
<td>20%</td>
<td>$16,000</td>
</tr>
<tr>
<td>Third</td>
<td>$64,000</td>
<td>20%</td>
<td>$12,800</td>
</tr>
<tr>
<td>Fourth</td>
<td>$51,200</td>
<td>20%</td>
<td>$10,240</td>
</tr>
</tbody>
</table>

**Note:** A taxpayer may change from the declining balance method of accounting to the straight-line balance method without first obtaining the consent of the FTB. (R&TC §24352; 18 Cal. Code Regs. §24352)

**Sum-of-the-years digits method**

This method may be used whenever the declining balance method is allowed. The depreciation deduction is figured by subtracting the salvage value from the cost of the property and multiplying the result by a fraction.
The numerator of the fraction is the number of years remaining in the useful life of the property. So the numerator changes each year as the life of the property decreases. The denominator of the fraction is the sum of the digits representing the years of useful life, and therefore remains constant. For example, if the useful life is 3 years, the denominator would be 6 (3+2+1).

Example of sum-of-the-years depreciation calculation

In January, a corporation purchases a deluxe copier for $125,000 with a useful life of seven years and a salvage value of $15,000. The depreciation deduction using the sum-of-the-years digits method would be calculated as in the following chart.

<table>
<thead>
<tr>
<th>Year</th>
<th>Book Value Year Start</th>
<th>Total Cost Depreciable</th>
<th>Depreciation Percentage</th>
<th>Depreciation Expense</th>
<th>Accumulated Depreciation</th>
<th>Book Value Year End</th>
</tr>
</thead>
<tbody>
<tr>
<td>2014</td>
<td>$125,000</td>
<td>$110,000</td>
<td>25% (7/28)</td>
<td>$27,500</td>
<td>$27,500</td>
<td>$97,500</td>
</tr>
<tr>
<td>2015</td>
<td>$97,500</td>
<td>$110,000</td>
<td>21% (6/28)</td>
<td>$23,571</td>
<td>$51,071</td>
<td>$73,929</td>
</tr>
<tr>
<td>2016</td>
<td>$73,929</td>
<td>$110,000</td>
<td>18% (5/28)</td>
<td>$19,643</td>
<td>$70,714</td>
<td>$54,286</td>
</tr>
<tr>
<td>2017</td>
<td>$54,286</td>
<td>$110,000</td>
<td>14% (4/28)</td>
<td>$15,714</td>
<td>$86,429</td>
<td>$38,571</td>
</tr>
<tr>
<td>2018</td>
<td>$38,571</td>
<td>$110,000</td>
<td>11% (3/28)</td>
<td>$11,786</td>
<td>$98,214</td>
<td>$26,786</td>
</tr>
<tr>
<td>2019</td>
<td>$26,786</td>
<td>$110,000</td>
<td>7% (2/28)</td>
<td>$7,857</td>
<td>$106,071</td>
<td>$18,929</td>
</tr>
<tr>
<td>2020</td>
<td>$18,929</td>
<td>$110,000</td>
<td>4% (1/28)</td>
<td>$3,929</td>
<td>$110,000</td>
<td>$15,000</td>
</tr>
</tbody>
</table>

Other consistent methods

Other depreciation methods, such as the sinking fund method, may be used as long as the total accumulated depreciation at the end of any taxable year during the first two-thirds of the useful life of the property is not more than the amount that would have resulted from using the declining balance method.

Salvage value

Salvage value is the estimated amount, at the time of acquisition, that will be realizable upon an asset’s sale or other disposition when it is no longer useful in the taxpayer’s trade or business and is to be retired from service by the taxpayer. Salvage value may not be changed at any time after the determination is made at the time of acquisition merely because of changes in price levels. However, if there is a redetermination of useful life, salvage value may be redetermined based upon facts known at the time of such redetermination. (18 Cal. Code Regs. §24349(a))

The salvage value may not exceed 10% of the basis of the personal property with a useful life of at least three years being depreciated. (R&TC §24352.5)

Salvage, when reduced by the cost of removal, is referred to as net salvage. The time at which an asset is retired from service may vary according to the policy of the taxpayer.

If the taxpayer’s policy is to dispose of assets that are still in good operating condition, the salvage value may represent a relatively large proportion of the original basis of the asset. However, if the taxpayer customarily uses an asset until its inherent useful life has been substantially exhausted, salvage value may represent no more than junk value.
The taxpayer may use either salvage or net salvage in determining depreciation allowances, but such practice must be consistently followed, and the treatment of the costs of removal must be consistent with the practice adopted.

When an asset is retired or disposed of, appropriate adjustments must be made in the asset and depreciation reserve accounts. For example, the amount of the salvage adjusted for the costs of removal may be credited to the depreciation reserve.

**Period of depreciation**

California generally conforms to the federal useful lives of property that was adopted pursuant to Treas. Regs. §1.167(a)(11); however California did not adopt the 20% +/- range that allowed taxpayers to increase or decrease the asset guideline period for an asset guideline class by 20%. (18 Cal. Code Regs. §24349(l))

Consequently, taxpayers may use the useful life information provided in the instructions to FTB Form 3885, Corporation Depreciation and Amortization, as a guide to determine reasonable periods of useful life for depreciation purposes. However, actual facts and circumstances may be taken into account. For example, trucks used in Detroit are likely to have a much shorter useful life than those used in San Diego. Factors to consider include:

- Wear and tear and decay or decline from natural causes;
- The normal progress of the art, economic changes, inventions, and current developments within the industry or business;
- The climatic and other local conditions peculiar to the taxpayer’s trade or business; and
- The taxpayer’s policy as to repairs, renewals, and replacements. (18 Cal. Code Regs. §24349(a))

The estimated remaining useful life may be subject to modification by reason of conditions known to exist at the end of the taxable year but only when the change in the useful life is significant, and there is a clear and convincing basis for the redetermination. (18 Cal. Code Regs. §24349(a)(2))

Below is a summary of the normal periods of useful life for the types of property listed as shown in IRS Rev. Proc. 87-56:

- **Office furniture, fixtures, machines and equipment** 10 years
  This category includes furniture and fixtures (that are not structural components of a building) and machines and equipment used in the preparation of paper or data.
  Examples include:
  - Files;
  - Safes;
  - Typewriters;
  - Accounting, calculating, and data processing machines;
  - Communications equipment; and
  - Copying equipment.

- **Computers and peripheral equipment (e.g., printers)** 6 years

- **Transportation equipment and automobiles (including taxis)** 3 years

- **General purpose trucks:**
  - Light (unloaded weight less than 13,000 pounds) 4 years
  - Heavy (unloaded weight 13,000 pounds or more) 6 years
• Buildings (including the structure shell of a building and all its integral parts that service normal heating, plumbing, air conditioning, fire prevention and power requirements, and equipment such as elevators and escalators.

Type of building:
  - Apartments
  - Dwellings (including rental residences)
  - Office buildings
  - Warehouses

**Leased property**

A lessee’s leasehold improvements are depreciated over the applicable recovery period (discussed above) if the improvement’s useful life is equal to or shorter than the remaining period of the lease. However, if the improvement’s useful life is longer than the remaining period of the lease, the unrecovered cost of the capital expenditures must be divided by the number of years remaining in the terms of the lease.

Capital expenditures made by the lessor for the buildings or other improvements are recovered over the estimated life of the improvements without regard to the period of the lease. (18 Cal. Code Regs. §24349(d))

**Patents or copyrights**

The cost or other basis of a patent or copyright is depreciated over its remaining useful life. Its cost to the patentee includes the various government fees, cost of drawings, models, attorney’s fees, and similar expenditures. If a patent or copyright becomes valueless in any year before its expiration, the unrecovered cost or other basis may be deducted in that year. (18 Cal. Code Regs. §24349(f)(a))

**Rent-to-own property**

The class life for rent-to-own property is four years for California purposes, but three years for federal purposes. (IRC §168(e)(3)(A)(iii); R&TC §24355.4)

**Which depreciation methods to use?**

Corporations may use the straight-line method for any depreciable property. Before using other methods, consider the kind of property, its useful life, whether it is new or used, and the date it was acquired.
The following chart can be used as a general guide to determine which method to use:

<table>
<thead>
<tr>
<th>Property description</th>
<th>Maximum depreciation method</th>
</tr>
</thead>
<tbody>
<tr>
<td>Residential rental real estate acquired January 1, 1971, or later:</td>
<td></td>
</tr>
<tr>
<td>New</td>
<td>200% Declining balance</td>
</tr>
<tr>
<td>Used (useful life 20 years or more)</td>
<td>125% Declining balance</td>
</tr>
<tr>
<td>Used (useful life less than 20 years)</td>
<td>Straight-line</td>
</tr>
<tr>
<td>Commercial and industrial real estate acquired January 1, 1971 or later:</td>
<td></td>
</tr>
<tr>
<td>New (useful life three years or more)</td>
<td>150% Declining balance</td>
</tr>
<tr>
<td>Used</td>
<td>Straight-line</td>
</tr>
<tr>
<td>Personal property:</td>
<td></td>
</tr>
<tr>
<td>New (useful life three years or more)</td>
<td>200% Declining balance</td>
</tr>
<tr>
<td>Used (useful life three years or more)</td>
<td>150% Declining balance</td>
</tr>
</tbody>
</table>

**Additional first-year depreciation allowance**

In lieu of the IRC §179 expense election (as modified for California purposes), taxpayers may claim an additional first-year depreciation allowance. The allowance is equal to 20% of the cost of the property, up to a $2,000 maximum per taxpayer per year. All members of an affiliated group are considered one taxpayer for purposes of the depreciation allowance. (RT&C §24356)

If the property purchased by the taxpayer in a taxable year exceeds the $2,000 limitation, the taxpayer may select the cost or portion of the cost of property to which its election is to apply. (18 Cal. Code Regs. §24356-1)

Property converted from personal use, acquired by gift, inheritance, or from related parties also does not qualify. However, unlike the IRC §168(k) requirements, the taxpayer is not required to be the first user of the property.
Name of filer (name of parent corporation if a consolidated group) (see instructions)  

Identification number (see instructions)  
111-11-1111  

Principal business activity code number (see instructions)  
561730  

MATTIE RIALS  

Number, street, and room or suite no. If a P.O. box, see the instructions.  

123 ANY STREET  

City or town, state, and zip code  
EVERYTOWN, CA 99999  

Name of contact person (see instructions)  
MATTIE RIALS  

Contact person’s telephone number  

If the applicant is a member of a consolidated group, check this box.  

If Form 2848, Power of Attorney and Declaration of Representative, is attached (see instructions for when Form 2848 is required), check this box.  

Check the box to indicate the applicant.  

Check the appropriate box to indicate the type of accounting method change being requested. (see instructions)  

Cooperative (Section 1381)  

X  

Depreciation or Amortization  

Other (specify) . . . Other (specify)  

Part I | Information For Automatic Change Request  

Yes  
No  

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

(a) Change No.  
(b) Other  
Description  

2 Do any of the scope limitations described in section 4.02 of Rev Proc 2008-52 cause automatic consent to be unavailable for the applicant’s requested change? If ‘Yes,’ attach an explanation.  

Yes  
No  

Part II | Information For All Requests  

Yes  
No  

3 Did or will the applicant cease to engage in the trade or business to which the requested change relates, or terminate its existence, in the tax year of change (see instructions)  

If ‘Yes,’ the applicant is not eligible to make the change under automatic change request procedures.  

4a Does the applicant (or any present or former consolidated group in which the applicant was a member during the applicable tax year(s)) have any Federal income tax return(s) under examination (see instructions)?  

If ‘No’, go to line 5.  

Yes  
No  

b Is the method of accounting the applicant is requesting to change an issue (with respect to either the applicant or any present or former consolidated group in which the applicant was a member during the applicable tax year(s)) either (i) under consideration or (ii) placed in suspense (see instructions)?  

Signature (see instructions)  

Filer  
Preparer (other than filer/applicant)  

Name and title (print or type)  

SEID & COMPANY, CPAS  
935 RIVERSIDE AVENUE, SUITE 1  
PASO ROBLES, CA 93446  

BAA For Privacy Act and Paperwork Reduction Act Notice, see the instructions.  

Form 3115 (Rev 12-2009)  

FDIZ3213L 03/25/10
### Part II Information For All Requests

<table>
<thead>
<tr>
<th></th>
<th>Yes</th>
<th>No</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>4c</strong> Is the method of accounting the applicant is requesting to change an issue pending (with respect to either the applicant or any present or former consolidated group in which the applicant was a member during the applicable tax year(s)) for any tax year under examination (see instructions)?</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>d</strong> Is the request to change the method of accounting being filed under the procedures requiring that the operating division director consent to the filing of the request (see instructions)?</td>
<td></td>
<td></td>
</tr>
<tr>
<td>If 'Yes,' attach the consent statement from the director.</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>e</strong> Is the request to change the method of accounting being filed under the 90-day or 120-day window period?</td>
<td></td>
<td></td>
</tr>
<tr>
<td>If 'Yes,' check the box for the applicable window period and attach the required statement (see instructions).</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>90 day</td>
<td>120 day: Date examination ended</td>
</tr>
<tr>
<td><strong>f</strong> If you answered 'Yes' to line 4a, enter the name and telephone number of the examining agent and the tax year(s) under examination.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Name</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Telephone number</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Tax year(s)</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>g</strong> Has a copy of this Form 3115 been provided to the examining agent identified on line 4f?</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>5a</strong> Does the applicant (or any present or former consolidated group in which the applicant was a member during the applicable tax year(s)) have any Federal income tax return(s) before Appeals and/or a Federal court?</td>
<td></td>
<td>X</td>
</tr>
<tr>
<td>If 'Yes,' enter the name of the (check the box)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Appeals officer and/or</td>
<td></td>
<td></td>
</tr>
<tr>
<td>counsel for the government, and the tax year(s) before Appeals and/or a Federal court.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Name</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Telephone number</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Tax year(s)</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>b</strong> Has a copy of this Form 3115 been provided to the Appeals officer and/or counsel for the government identified on line 5a?</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>c</strong> Is the method of accounting the applicant is requesting to change an issue under consideration by Appeals and/or a Federal court (for either the applicant or any present or former consolidated group in which the applicant was a member for the tax year(s) the applicant was a member) (see instructions)?</td>
<td></td>
<td></td>
</tr>
<tr>
<td>If 'Yes,' attach an explanation.</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>6</strong> If the applicant answered 'Yes' to line 4a and/or 5a with respect to any present or former consolidated group, attach a statement that provides each parent corporation's (a) name, (b) identification number, (c) address, and (d) tax year(s) during which the applicant was a member that is under examination, before an Appeals office, and/or before a Federal court.</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>7</strong> If, for federal income tax purposes, the applicant is either an entity (including a limited liability company) treated as a partnership or an S corporation, is it requesting a change from a method of accounting that is an issue under consideration in an examination, before Appeals, or before a Federal court, with respect to a Federal income tax return of a partner, member, or shareholder of that entity?</td>
<td></td>
<td></td>
</tr>
<tr>
<td>If 'Yes,' the applicant is not eligible to make the change.</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>8 a</strong> Does the applicable revenue procedure (advance consent or automatic consent) state that the applicant does not receive audit protection for the requested change (see instructions)?</td>
<td>X</td>
<td></td>
</tr>
<tr>
<td><strong>b</strong> If 'Yes,' attach an explanation.</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>9 a</strong> Has the applicant, its predecessor, or a related party requested or made (under either an automatic change procedure or a procedure requiring advance consent) a change in method of accounting within the past 5 years (including the year of the requested change)?</td>
<td></td>
<td>X</td>
</tr>
<tr>
<td><strong>b</strong> If 'Yes,' for each trade or business, attach a description of each requested change in method of accounting (including the tax year of change) and state whether the applicant received consent.</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>c</strong> If any application was withdrawn, not perfected, or denied, or if a Consent Agreement granting a change was sent to the taxpayer but was not signed and returned to the IRS, or if the change was not made or not made in the requested year of change, attach an explanation.</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>10 a</strong> Does the applicant, its predecessor, or a related party currently have pending any request (including any concurrently filed request) for a private letter ruling, change in method of accounting, or technical advice?</td>
<td></td>
<td>X</td>
</tr>
<tr>
<td><strong>b</strong> If 'Yes,' for each request attach a statement providing the name(s) of the taxpayer, identification number(s), the type of request (private letter ruling, change in method of accounting, or technical advice), and the specific issue(s) in the request(s).</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>11</strong> Is the applicant requesting to change its overall method of accounting?</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Present method:** Cash Accrual Hybrid (attach description)

**Proposed method:** Cash Accrual Hybrid (attach description)
Part II | Information For All Requests (continued)

12 If the applicant is either (i) not changing its overall method of accounting, or (ii) is changing its overall method of accounting and also changing to a special method of accounting for one or more items, attach a detailed and complete description for each of the following:
   a. The item(s) being changed.
   b. The applicant's present method for the item(s) being changed.
   c. The applicant's proposed method for the item(s) being changed.
   d. The applicant's present overall method of accounting (cash, accrual, or hybrid).

13 Attach a detailed and complete description of the applicant's trade(s) or business(es), and the principal business activity code for each. If the applicant has more than one trade or business as defined in Regulations section 1.446-1(d), describe: whether each trade or business is accounted for separately; the goods and services provided by each trade or business; and any other types of activities engaged in that generate gross income; the overall method of accounting for each trade or business; and which trade or business is requesting to change its accounting method as part of this application or a separate application.

14 Will the proposed method of accounting be used for the applicant's books and records and financial statements? For insurance companies, see the instructions. 
   If 'No,' attach an explanation.

15a Has the applicant engaged, or will it engage, in a transaction to which section 381(a) applies (e.g., a reorganization, merger, or liquidation) during the proposed tax year of change determined without regard to any potential closing of the year under section 471? 
   b. If 'Yes,' for the items of income and expense that are the subject of this application, attach a statement identifying the methods of accounting used by the parties to the section 381(a) transaction immediately before the date of distribution or transfer and the method(s) that would be required by section 381(c)(4) or (c)(5) absent consent to the change(s) requested in this application.

16 Does the applicant request a conference with the IRS National Office if the IRS proposes an adverse response? 

17 If the applicant is changing to either the overall cash method, an overall accrual method, or is changing its method of accounting for any property subject to section 263A, any long-term contract subject to section 460, or inventories subject to section 474, enter the applicant's gross receipts for the 3 tax years preceding the tax year of change.

18 Is the applicant's requested change described in any revenue procedure, revenue ruling, notice, regulation, or other published guidance as an automatic change request?
   If 'Yes,' attach an explanation describing why the applicant is submitting its request under advance consent request procedures.

19 Attach a full explanation of the legal basis supporting the proposed method for the item being changed. Include a detailed and complete description of the facts that explains how the law specifically applies to the applicant's situation and that demonstrates that the applicant is authorized to use the proposed method. Include all authority (statutes, regulations, published rulings, court cases, etc.) supporting the proposed method. Also, include either a discussion of the contrary authorities or a statement that no contrary authority exists.

20 Attach a copy of all documents related to the proposed change (see instructions).

21 Attach a statement of the applicant's reasons for the proposed change.

22 If the applicant is a member of a consolidated group for the year of change, do all other members of the consolidated group use the proposed method of accounting for the item being changed?
   If 'No', attach an explanation.

23a Enter the amount of user fee attached to this application (see instructions).
   b. If the applicant qualifies for a reduced user fee, attach the required information or certification (see instructions).

Part IV | Section 481(a) Adjustment

24 Does the applicable revenue procedure, revenue ruling, notice, regulation, or other published guidance require the applicant to implement the requested change in method of accounting on a cut-off basis rather than a section 481(a) adjustment?
   If 'Yes,' do not complete lines 25, 26, and 27 below.

25 Enter the section 481(a) adjustment. Indicate whether the adjustment is an increase (+) or a decrease (-) in income.
   If 'Yes,' do not complete lines 25, 26, and 27 below.

   $ -4,000. 

   Attach a summary of the computation and an explanation of the methodology used to determine the section 481(a) adjustment. If it is based on more than one component, show the computation for each component.

   If more than one applicant is applying for the method change on the same application, attach a list of the name, identification number, principal business activity code (see instructions), and the amount of the section 481(a) adjustment attributable to each applicant.

See Attachment 2
Applicants requesting a change to the cash method must attach the following information:

<table>
<thead>
<tr>
<th>Schedule A</th>
<th>Schedule B</th>
<th>Form Part II</th>
<th>Change to the Cash Method For Advance Consent Request</th>
<th>Part I</th>
<th>Part II</th>
</tr>
</thead>
<tbody>
<tr>
<td>Schedule B</td>
<td>Schedule A</td>
<td>Form Part II</td>
<td>Change to the Cash Method For Advance Consent Request</td>
<td>Part I</td>
<td>Part II</td>
</tr>
</tbody>
</table>

### Schedule A – Change in Overall Method of Accounting
(If Schedule A applies, Part I below must be completed.)

#### Part I Change in Overall Method
(see instructions)

1. Enter the following amounts as of the close of the tax year preceding the year of change. If none, state 'None.' Also, attach a statement providing a breakdown of the amounts entered on lines 1a through 1g.

<table>
<thead>
<tr>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>$</td>
</tr>
</tbody>
</table>

- **a.** Income accrued but not received.
- **b.** Income received or reported before it was earned (such as advanced payments). Attach a description of the income and the legal basis for the proposed method.
- **c.** Expenses accrued but not paid (such as accounts payable).
- **d.** Prepaid expenses previously deducted.
- **e.** Supplies on hand previously deducted and/or not previously reported.
- **f.** Inventory on hand previously deducted and/or not previously reported. Complete Schedule D, Part II.
- **g.** Other amounts (specify). Attach a description of the item and the legal basis for its inclusion in the calculation of the section 481(a) adjustment.
- **h.** Net section 481(a) adjustment (Combine lines 1a – 1g). Indicate whether the adjustment is an increase (+) or decrease (-) in income. Also enter the net amount of this section 481(a) adjustment amount on Part IV, line 25.

- **2.** Is the applicant also requesting the recurring item exception under section 461(h)(3)?

<table>
<thead>
<tr>
<th>Yes</th>
<th>No</th>
</tr>
</thead>
</table>

- **3.** Attach copies of the profit and loss statement (Schedule F (Form 1040) for farmers) and the balance sheet, if applicable, as of the close of the tax year preceding the year of change. Also attach a statement specifying the accounting method used when preparing the balance sheet. If books of account are not kept, attach a copy of the business schedules submitted with the Federal income tax return or other return (e.g., tax-exempt organization returns) for that period. If the amounts in Part I, lines 1a through 1g, do not agree with those shown on both the profit and loss statement and the balance sheet, attach a statement explaining the differences.

#### Part II Change to the Cash Method For Advance Consent Request
(see instructions)

Applicants requesting a change to the cash method must attach the following information:

1. A description of inventory items (items whose production, purchase, or sale is an income-producing factor) and materials and supplies used in carrying out the business.

2. An explanation as to whether the applicant is required to use the accrual method under any section of the Code or regulations.

#### Schedule B – Change in Reporting Advance Payments
(see instructions)

1. If the applicant is requesting to change to the Deferral Method for advance payments described in section 5.02 of Rev Proc 2004-34, 2004-1 CB 991, attach the following information:

   - A statement explaining how the advance payments meet the definition in section 4.01 of Rev Proc 2004-34.
   - If the applicant is filing under the automatic change procedures of Rev Proc 2008-52, the information required by section 8.02(3)(a)-(c) of Rev Proc 2004-34.
   - If the applicant is filing under the advance consent provisions of Rev Proc 97-27, the information required by section 8.03(2)(a)-(f) of Rev Proc 2004-34.

2. If the applicant is requesting to change to the deferral method for advance payments described in Regulations section 1.451-5(b)(1)(ii), attach the following:

   - A statement explaining how the advance payments meet the definition in Regulations section 1.451-5(a)(1).
   - A statement explaining what portions of the advance payments, if any, are attributable to services, whether such services are integral to the provisions of goods or items, and whether any portions of the advance payments that are attributable to non-integral services are less than five percent of the total contract prices. See Regulations sections 1.451-5(a)(2)(i) and (3).
   - A statement explaining that the advance payments will be included in income no later than when included in gross receipts for purposes of the applicant's financial reports. See Regulations section 1.451-5(b)(1)(ii).
   - A statement explaining whether the inventoriable goods exception of Regulations section 1.451-5(c) applies and if so, when substantial advance payments will be received under the contracts, and how the exception will limit the deferral of income.
Schedule C — Changes Within the LIFO Inventory Method (see instructions)

### Part I  General LIFO Information

Complete this section if the requested change involves changes within the LIFO inventory method. Also, attach a copy of all Forms 970, Application To Use LIFO Inventory Method, filed to adopt or expand the use of the LIFO method.

1. Attach a description of the applicant's present and proposed LIFO methods and submethods for each of the following items:
   - Valuing inventory (e.g., unit method or dollar-value method).
   - Pooling (e.g., by line or type or class of goods, natural business unit, multiple pools, raw material content, simplified dollar-value method, inventory price index computation (IPIC) pools, vehicle-pool method, etc).
   - Pricing dollar-value pools (e.g., double-extension, index, link-chain, link-chain index, IPIC method, etc).
   - Determining the current-year cost of goods in the ending inventory (i.e., most recent acquisitions, earliest acquisitions during the current year, average cost of current-year acquisitions, or other permitted method).

2. If any present method or submethod used by the applicant is not the same as indicated on Form(s) 970 filed to adopt or expand the use of the method, attach an explanation.

3. If the proposed change is not requested for all the LIFO inventory, attach a statement specifying the inventory to which the change is and is not applicable.

4. If the proposed change is not requested for all of the LIFO pools, attach a statement specifying the LIFO pool(s) to which the change is applicable.

5. Attach a statement addressing whether the applicant values any of its LIFO inventory on a method other than cost. For example, if the applicant values some of its LIFO inventory at retail and the remainder at cost, identify which inventory items are valued under each method.

6. If changing to the IPIC method, attach a completed Form 970.

### Part II  Change in Pooling Inventories

1. If the applicant is proposing to change its pooling method or the number of pools, attach a description of the contents of, and state the base year for, each dollar-value pool the applicant presently uses and proposes to use.

2. If the applicant is proposing to use natural business unit (NBU) pools or requesting to change the number of NBU pools, attach the following information (to the extent not already provided) in sufficient detail to show that each proposed NBU was determined under Regulations section 1.472-8(b)(1) and (2):
   - A description of the types of products produced by the applicant. If possible, attach a brochure.
   - A description of the types of processes and raw materials used to produce the products in each proposed pool.

3. If all of the products to be included in the proposed NBU pool(s) are not produced at one facility, state the reasons for the separate facilities, the location of each facility, and a description of the products each facility produces.

4. A description of the natural business divisions adopted by the taxpayer. State whether separate cost centers are maintained and if separate profit and loss statements are prepared.

5. A statement addressing whether the applicant has inventories of items purchased and held for resale that are not further processed by the applicant, including whether such items, if any, will be included in any proposed NBU pool.

6. A statement addressing whether all items including raw materials, goods-in-process, and finished goods entering into the entire inventory investment for each proposed NBU pool are presently valued under the LIFO method. Describe any items that are not presently valued under the LIFO method that are to be included in each proposed pool.

7. A statement addressing whether, within the proposed NBU pool(s), there are items both sold to unrelated parties and transferred to a different unit of the applicant to be used as a component part of another product prior to final processing.

3. If the applicant is engaged in manufacturing and is proposing to use the multiple pooling method or raw material content pools, attach information to show that each proposed pool will consist of a group of items that are substantially similar. See Regulations section 1.472-8(b)(3).

4. If the applicant is engaged in the wholesaling or retailing of goods and is requesting to change the number of pools used, attach information to show that each of the proposed pools is based on customary business classifications of the applicant's trade or business. See Regulations section 1.472-8(c).
Part I | Change in Reporting Income From Long-Term Contracts (Also complete Part III on pages 7 and 8.)

1 To the extent not already provided, attach a description of the applicant's present and proposed methods for reporting income and expenses from long-term contracts. Also, attach a representative actual contract (without any deletion) for the requested change. If the applicant is a construction contractor, attach a detailed description of its construction activities.

2a Are the applicant's contracts long-term contracts as defined in section 460(f)(1) (see instructions)?

   b If 'Yes,' do all the contracts qualify for the exception under section 460(e) (see instructions)?

   c If line 2b is 'Yes,' is the applicant requesting to use the percentage-of-completion method using cost-to-cost under Regulations section 1.460-4(b)?

   d If line 2c is 'No,' is the applicant requesting to use the exempt-contract percentage-of-completion method under Regulations section 1.460-4(c)(2)?

   e If line 2d is 'Yes,' attach an explanation of what cost comparison the applicant will use to determine a contract's completion factor.

   f If line 2d is 'No,' attach an explanation of what method the applicant is using and the authority for its use.

3a Does the applicant have long-term manufacturing contracts as defined in section 460(f)(2)?

   b If 'Yes,' attach an explanation of the applicant's present and proposed method(s) of accounting for long-term manufacturing contracts.

   c Attach a description of the applicant's manufacturing activities, including any required installation of manufactured goods.

4 To determine a contract's completion factor using the percentage-of-completion method:

   a Will the applicant use the cost-to-cost method in Regulations section 1.460-4(b)?

   b If line 4a is 'No,' is the applicant electing the simplified cost-to-cost method (see section 460(b)(3) and Regulations section 1.460-5(c))? If 'Yes,' do all the contracts qualify for the exception under section 460(e) (see instructions)?

5 Attach a statement indicating whether any of the applicant's contracts are either cost-plus long-term contracts or Federal long-term contracts.

Part II | Change in Valuing Inventories Including Cost Allocation Changes (Also complete Part III on pages 7 and 8.)

1 Attach a description of the inventory goods being changed.

2 Attach a description of the inventory goods (if any) NOT being changed.

3a Is the applicant subject to section 263A? If 'No,' go to line 3b.

   b Is the applicant's present inventory valuation method in compliance with section 263A (see instructions)?

4a Check the appropriate boxes below.

   Identification methods:
   - Specific identification
   - FIFO
   - LIFO
   - Other (attach explanation)

   Valuation methods:
   - Cost
   - Cost or market, whichever is lower
   - Retail cost
   - Retail, lower of cost or market
   - Other (attach explanation)

   b Enter the value at the end of the tax year preceding the year of change.

5 If the applicant is changing from the LIFO inventory method to a non-LIFO method, attach the following information. (see instructions).

   a Copies of Form(s) 970 filed to adopt or expand the use of the method.

   b Only for applicants requesting advance consent. A statement describing whether the applicant is changing to the method required by Regulations section 1.472-6(a) or (b), or whether the applicant is proposing a different method.

   c Only for applicants requesting an automatic change. The statement required by section 22.01(5) of the Appendix of Rev Proc 2008-52 (or its successor).
**Section A — Allocation and Capitalization Methods**

Attach a description (including sample computations) of the present and proposed method(s) the applicant uses to capitalize direct and indirect costs properly allocable to real or tangible personal property produced and property acquired for resale, or to allocate and, where appropriate, capitalize direct and indirect costs properly allocable to long-term contracts, include a description of the method(s) used for allocating indirect costs to intermediate cost objectives such as departments or activities prior to the allocation of such costs to long-term contracts, real or tangible personal property produced, and property acquired for resale. The description must include the following:

1. The method of allocating direct and indirect costs (i.e., specific identification, burden rate, standard cost, or other reasonable allocation method).

2. The method of allocating mixed service costs (i.e., direct reallocation, step-allocation, simplified service cost using the labor-based allocation ratio, simplified service cost using the production cost allocation ratio, or other reasonable allocation method).

3. The method of capitalizing additional section 263A costs (i.e., simplified production with or without the historic absorption ratio election, simplified resale with or without the historic absorption ratio election including permissible variations, the U.S. ratio, or other reasonable allocation method).

**Section B — Direct and Indirect Costs Required To Be Allocated**

Check the appropriate boxes showing the costs that are or will be fully included, to the extent required, in the cost of real or tangible personal property produced or property acquired for resale under section 263A or allocated to long-term contracts under section 460. Mark ‘N/A’ in a box if those costs are not incurred by the applicant. If a box is not checked, it is assumed that those costs are not fully included to the extent required. Attach an explanation for boxes that are not checked.

<table>
<thead>
<tr>
<th>Cost Description</th>
<th>Present method</th>
<th>Proposed method</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Direct material.</td>
<td></td>
<td></td>
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<tr>
<td>2. Direct labor.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>3. Indirect labor.</td>
<td></td>
<td></td>
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<tr>
<td>4. Officers’ compensation (not including selling activities).</td>
<td></td>
<td></td>
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<tr>
<td>5. Pension and other related costs.</td>
<td></td>
<td></td>
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<tr>
<td>7. Indirect materials and supplies.</td>
<td></td>
<td></td>
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<tr>
<td>8. Purchasing costs.</td>
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<td></td>
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<tr>
<td>9. Handling, processing, assembly, and repackaging costs.</td>
<td></td>
<td></td>
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<tr>
<td>10. Offsite storage and warehousing costs.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>11. Depreciation, amortization, and cost recovery allowance for equipment and facilities placed in service and not temporarily idle</td>
<td></td>
<td></td>
</tr>
<tr>
<td>12. Depletion.</td>
<td></td>
<td></td>
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<tr>
<td>13. Rent.</td>
<td></td>
<td></td>
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<tr>
<td>14. Taxes other than state, local, and foreign income taxes.</td>
<td></td>
<td></td>
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<tr>
<td>15. Insurance.</td>
<td></td>
<td></td>
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<tr>
<td>17. Maintenance and repairs that relate to a production, resale, or long-term contract activity</td>
<td></td>
<td></td>
</tr>
<tr>
<td>18. Engineering and design costs (not including section 174 research and experimental expenses).</td>
<td></td>
<td></td>
</tr>
<tr>
<td>19. Rework labor, scrap, and spoilage.</td>
<td></td>
<td></td>
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<tr>
<td>20. Tools and equipment.</td>
<td></td>
<td></td>
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<tr>
<td>22. Bidding expenses incurred in the solicitation of contracts awarded to the applicant.</td>
<td></td>
<td></td>
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<tr>
<td>23. Licensing and franchise costs.</td>
<td></td>
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<tr>
<td>24. Capitalizable service costs (including mixed service costs).</td>
<td></td>
<td></td>
</tr>
<tr>
<td>25. Administrative costs (not including any costs of selling or any return on capital).</td>
<td></td>
<td></td>
</tr>
<tr>
<td>26. Research and experimental expenses attributable to long-term contracts.</td>
<td></td>
<td></td>
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<tr>
<td>27. Interest.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>28. Other costs (Attach a list of these costs.).</td>
<td></td>
<td></td>
</tr>
<tr>
<td>BAA</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
### Section C — Other Costs Not Required To Be Allocated

(Complete Section C only if the applicant is requesting to change its method for these costs.)

<table>
<thead>
<tr>
<th></th>
<th>Present method</th>
<th>Proposed method</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Marketing, selling, advertising, and distribution expenses.</td>
<td></td>
</tr>
<tr>
<td>2</td>
<td>Research and experimental expenses not included in Section B, line 26.</td>
<td></td>
</tr>
<tr>
<td>3</td>
<td>Bidding expenses not included in Section B, line 22.</td>
<td></td>
</tr>
<tr>
<td>4</td>
<td>General and administrative costs not included in Section B.</td>
<td></td>
</tr>
<tr>
<td>5</td>
<td>Income taxes.</td>
<td></td>
</tr>
<tr>
<td>6</td>
<td>Cost of strikes.</td>
<td></td>
</tr>
<tr>
<td>7</td>
<td>Warranty and product liability costs.</td>
<td></td>
</tr>
<tr>
<td>8</td>
<td>Section 179 costs.</td>
<td></td>
</tr>
<tr>
<td>9</td>
<td>On-site storage.</td>
<td></td>
</tr>
<tr>
<td>10</td>
<td>Depreciation, amortization, and cost recovery allowance not included in Section B, line 11.</td>
<td></td>
</tr>
<tr>
<td>11</td>
<td>Other costs (Attach a list of these costs.)</td>
<td></td>
</tr>
</tbody>
</table>

### Schedule E — Change in Depreciation or Amortization

Applicants requesting approval to change their method of accounting for depreciation or amortization complete this section. Applicants must provide this information for each item or class of property for which a change is requested.

**Note:** See the List of Automatic Accounting Method Changes in the instructions for information regarding automatic changes under sections 56, 167, 168, 197, 1400I, 1400L, or former section 168. Do not file Form 3115 with respect to certain late elections and election revocations (see instructions).

1. Is depreciation for the property determined under Regulations section 1.167(a)-11 (CLADR)?
   - Yes
   - No

   *If 'Yes,' the only changes permitted are under Regulations section 1.167(a)-11(c)(1)(iii).*

2. Is any of the depreciation or amortization required to be capitalized under any Code section (e.g., section 263A)?
   - Yes
   - No

   *If 'Yes,' enter the applicable section.*

3. Has a depreciation, amortization, or expense election been made for the property (e.g., the election under section 168(f)(1), 179, or 179C)?
   - Yes
   - No

   *If 'Yes,' enter the applicable section.*

4. To the extent not already provided, attach a statement describing the property being changed. Include in the description the type of property, the year the property was placed in service, and the property's use in the applicant's trade or business or income-producing activity.
   - a If the property is residential rental property, did the applicant live in the property before renting it?
     - Yes
     - No

   - b If the property is public utility property?
     - Yes
     - No

   - c Is the property public utility property?
     - Yes
     - No

5. To the extent not already provided in the applicant's description of its present method, attach a statement explaining how the property is treated under the applicant's present method (e.g., depreciable property, inventory property, supplies under Regulations section 1.162-3, nondepreciable section 263(a) property, property deductible as a current expense, etc.).

6. If the property is not currently treated as depreciable or amortizable property, attach a statement of the facts supporting the proposed change to depreciable or amortize the property.

7. If the property is currently treated and/or will be treated as depreciable or amortizable property, the following information for both the present (if applicable) and proposed methods:
   - a The Code section under which the property is or will be depreciated or amortized (e.g., section 168(g)).
   - b The applicable asset class from Rev Proc 87-56, 1987-2 CB 674, for each asset depreciated under section 168 (MACRS) or under section 1400L; the applicable asset class from Rev Proc 83-35, 1983-1 CB 745, for each asset depreciated under former section 168 (ACRS); an explanation why no asset class is identified for each asset for which an asset class has not been identified by the applicant.
   - c The facts to support the asset class for the proposed method.
   - d The depreciation or amortization method of the property, including the applicable Code section (e.g., 200% declining balance method under section 168(b)(1)).
   - e The useful life, recovery period, or amortization period of the property.
   - f The applicable convention of the property.

8. A statement of whether or not the additional first-year special depreciation allowance (for example, as provided by section 168(k), 168(l), 168(m), 168(n), 1400L(b), or 1400N(d)) was or will be claimed for the property. If not, also provide an explanation as to why no special depreciation allowance was or will be claimed.
Attachment 1
Form 3115, Part II, Line 12
Description of Item When Overall Method of Accounting Is Not Being Changed, or When Overall Method is Being Changed and Also Changing to a Special Method


Present method: The taxpayer's present method of accounting for small-engine gardening implements is to deduct the cost of such items when placed in service.

Proposed method: The taxpayer's proposed method of accounting for small-engine gardening implements is to deduct the cost of such items when purchased. This treatment follows Treas. Regs. Section 1.162-3(a)(2) as modified by T.D. 9639 issued 9/13/2013.

Present overall accounting method: Cash

Attachment 2
Form 3115, Part IV, Line 25
Methodology Used to Determine the Section 481(a) Adjustment

DCN #187: $(4,000)
IRC Section 481(a) adjustment represents the cost of small-engine gardening implements acquired prior to 1/1/2014 that has not been previously deducted.

NOTE: When multiple accounting method changes are made on the same Form 3115, a separate explanation is needed for each change in Part II, Line 12 and Part IV, Line 25.
Launderland Inc. owns a building in which it runs a coin-operated laundromat. Launderland purchased the building and placed it in service in 2005. In 2009, an earthquake damaged the roof, and it was replaced at a cost of $39,000. No loss was recognized and the original roof continued to be depreciated. The cost of the new roof was capitalized and has been depreciated since 2009. Launderland follows the new regulations and recognizes a loss on the disposition of the damaged roof. Because the roof was disposed of due to a casualty, a change from depreciating the original roof to recognizing a loss on its retirement is a change in accounting method under Treas. Regs. §1.168(i)-8(j)(5). Launderland determines the cost of the original roof to be $34,000 by discounting the cost of the new roof using the Producer Price Index for Final Demand. Calculated accumulated depreciation on the roof as of December 31, 2013, is $8,000. (Designated Change Number 205)

Launderland acquired and placed in service a bank of 10 clothes dryers in 2010 at a cost of $20,000. In 2012, two of the dryers were destroyed in a fire and replaced at a cost of $5,000. No loss was recognized and the original bank of dryers continued to be depreciated. The cost of the new dryers was capitalized and has been depreciated since 2010. Launderland determines the unadjusted basis of the disposed dryers to be $4,000 ($20,000 (original cost of 10 dryers) × 2/10 = $4,000). Allocated accumulated depreciation on the two dryers is $2,750. (Designated Change Number 206)

Launderland had average annual gross receipts of less than $10 million for the last three years.
Application for Change in Accounting Method

Name of filer (name of parent corporation if a consolidated group) (see instructions)  LAUNDERLAND INC. 
Identification number (see instructions)  812310 
Number, street, and room or suite no. If a P.O. box, see the instructions.  1234 ANY STREET 
City or town, state, and zip code  EVERYTOWN, CA 93446 
Name of contact person (see instructions)  JOHN LAUNDER 
Tax year of change begins (MM/DD/YYYY)  1/01/2014 
Tax year of change ends (MM/DD/YYYY)  12/31/2014 

If the applicant is a member of a consolidated group, check this box  
If Form 2848, Power of Attorney and Declaration of Representative, is attached (see instructions for when Form 2848 is required), check this box  

Check the box to indicate the applicant.  
- Individual  
- Corporation  
- Controlled foreign corporation (Section 957)  
- 10/50 corporation (Section 904(d)(2)(E))  
- Qualified personal service corporation (Section 448(d)(2))  
- Exempt organization. Enter Code section  

Check the appropriate box to indicate the type of accounting method change being requested.  
- Cooperative (Section 1381)  
- Partnership 
- S corporation  
- Insurance company (Section 816(a)) 
- Insurance company (Section 831) 
- Other (specify)  
- AUTOMATIC CHANGE REQUEST (MULTIPLE)  

Part I Information For Automatic Change Request  

1 requested change has no designated automatic accounting method change number, check 'Other,' and provide both a description of the change and citation of the IRS guidance providing the automatic change. See instructions.  

(a) Change No. 205, 206  
(b) Other  

2 the applicant's requested change? If 'Yes,' attach an explanation  

Note. Complete Part II below and then Part IV, and also Schedules A through E of this form (if applicable).  

Part II Information for All Requests  

3 Did or will the applicant cease to engage in the trade or business to which the requested change relates, or terminate its existence, in the tax year of change (see instructions)?  

Yes  

4 a Does the applicant (or any present or former consolidated group in which the applicant was a member during the applicable tax year(s)) have any Federal income tax return(s) under examination (see instructions)?  

Yes  

b or former consolidated group in which the applicant was a member during the applicable tax year(s)) either (i) under consideration or (ii) placed in suspense (see instructions)?  

Yes  

Signature (see instructions)  

Filer  
Preparer (other than filer/applicant)  

JOHN LAUNDER  
Seid & Company, CPAs  
PRESIDENT  
935 Riverside Avenue, Suite 1  
JOHN LAUNDER  
Paso Robles, CA 93446  

BAA For Privacy Act and Paperwork Reduction Act Notice, see the instructions.
### Part II Information For All Requests

<table>
<thead>
<tr>
<th>Question</th>
<th>Yes</th>
<th>No</th>
</tr>
</thead>
<tbody>
<tr>
<td>4c Is the method of accounting the applicant is requesting to change an issue pending (with respect to either the applicant or any present or former consolidated group in which the applicant was a member during the applicable tax year(s)) for any tax year under examination (see instructions)?</td>
<td></td>
<td></td>
</tr>
<tr>
<td>d Is the request to change the method of accounting being filed under the procedures requiring that the operating division director consent to the filing of the request (see instructions)?</td>
<td></td>
<td></td>
</tr>
<tr>
<td>e Is the request to change the method of accounting being filed under the 90-day or 120-day window period?</td>
<td></td>
<td></td>
</tr>
<tr>
<td>f If you answered 'Yes' to line 4a, enter the name and telephone number of the examining agent and the tax year(s) under examination.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>g Has a copy of this Form 3115 been provided to the examining agent identified on line 4f?</td>
<td>X</td>
<td></td>
</tr>
<tr>
<td>5a Does the applicant (or any present or former consolidated group in which the applicant was a member during the applicable tax year(s)) have any Federal income tax return(s) before Appeals and/or a Federal court?</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>b Has a copy of this Form 3115 been provided to the Appeals officer and/or counsel for the government identified on line 5a?</td>
<td></td>
<td></td>
</tr>
<tr>
<td>c Is the method of accounting the applicant is requesting to change an issue under consideration by Appeals and/or a Federal court (for either the applicant or any present or former consolidated group in which the applicant was a member for the tax year(s) the applicant was a member) (see instructions)?</td>
<td></td>
<td></td>
</tr>
<tr>
<td>6 If the applicant answered 'Yes' to line 4a and/or 5a with respect to any present or former consolidated group, attach a statement that provides each parent corporation's (a) name, (b) identification number, (c) address, and (d) tax year(s) during which the applicant was a member that is under examination, before an Appeals office, and/or before a Federal court.</td>
<td></td>
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</tr>
<tr>
<td>7 If, for federal income tax purposes, the applicant is either an entity (including a limited liability company) treated as a partnership or an S corporation, is it requesting a change from a method of accounting that is an issue under consideration in an examination, before Appeals, or before a Federal court, with respect to a Federal income tax return of a partner, owner, or shareholder of that entity?</td>
<td></td>
<td></td>
</tr>
<tr>
<td>8a Does the applicable revenue procedure (advance consent or automatic consent) state that the applicant does not receive audit protection for the requested change (see instructions)?</td>
<td>X</td>
<td></td>
</tr>
<tr>
<td>b If 'Yes,' attach an explanation.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>9a Has the applicant, its predecessor, or a related party requested or made (under either an automatic change procedure or a procedure requiring advance consent) a change in method of accounting within the past 5 years (including the year of the requested change)?</td>
<td>X</td>
<td></td>
</tr>
<tr>
<td>b If 'Yes,' for each trade or business, attach a description of each requested change in method of accounting (including the tax year of change) and state whether the applicant received consent.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>c If any application was withdrawn, not perfected, or denied, or if a Consent Agreement granting a change was sent to the taxpayer but was not signed and returned to the IRS, or if the change was not made or not made in the requested year of change, attach an explanation.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>10a Does the applicant, its predecessor, or a related party currently have pending any request (including any concurrently filed request) for a private letter ruling, change in method of accounting, or technical advice?</td>
<td>X</td>
<td></td>
</tr>
<tr>
<td>b If 'Yes,' for each request attach a statement providing the name(s) of the taxpayer, identification number(s), the type of request (private letter ruling, change in method of accounting, or technical advice), and the specific issue(s) in the request(s).</td>
<td></td>
<td></td>
</tr>
<tr>
<td>11 Is the applicant requesting to change its overall method of accounting?</td>
<td></td>
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</tr>
</tbody>
</table>

**Present method:**
- [ ] Cash
- [x] Accrual
- [ ] Hybrid (attach description)

**Proposed method:**
- [ ] Cash
- [x] Accrual
- [ ] Hybrid (attach description)
Form 3115 (Rev 12-2009) LAUNDERLAND INC. 22-2222222  Page 3

**Part II** Information For All Requests (continued)

<table>
<thead>
<tr>
<th></th>
<th>Yes</th>
<th>No</th>
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<tbody>
<tr>
<td>12</td>
<td></td>
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</tr>
<tr>
<td>If the applicant is either (i) not changing its overall method of accounting, or (ii) is changing its overall method of accounting and also changing to a special method of accounting for one or more items, attach a detailed and complete description for each of the following:</td>
<td>See Attachment 1</td>
<td></td>
</tr>
<tr>
<td>a</td>
<td>The item(s) being changed.</td>
<td></td>
</tr>
<tr>
<td>b</td>
<td>The applicant’s present method for the item(s) being changed.</td>
<td></td>
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<tr>
<td>c</td>
<td>The applicant’s proposed method for the item(s) being changed.</td>
<td></td>
</tr>
<tr>
<td>d</td>
<td>The applicant’s present overall method of accounting (cash, accrual, or hybrid).</td>
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<tr>
<td>13</td>
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<tr>
<td>Attach a detailed and complete description of the applicant’s trade(s) or business(es), and the principal business activity code for each. If the applicant has more than one trade or business as defined in Regulations section 1.446-1(d), describe: whether each trade or business is accounted for separately; the goods and services provided by each trade or business and any other types of activities engaged in that generate gross income; the overall method of accounting for each trade or business; and which trade or business is requesting to change its accounting method as part of this application or a separate application.</td>
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<tr>
<td>Will the proposed method of accounting be used for the applicant’s books and records and financial statements? For insurance companies, see the instructions.</td>
<td>If ‘No,’ attach an explanation.</td>
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<td>15a</td>
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<tr>
<td>Has the applicant engaged, or will it engage, in a transaction to which section 381(a) applies (e.g., a reorganization, merger, or liquidation) during the proposed tax year of change determined without regard to any potential closing of the year under section 381(b)(1)?</td>
<td>b If ‘Yes,’ for the items of income and expense that are the subject of this application, attach a statement identifying the methods of accounting used by the parties to the section 381(a) transaction immediately before the date of distribution or transfer and the method(s) that would be required by section 381(c)(4) or (c)(5) absent consent to the change(s) requested in this application.</td>
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<td>16</td>
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<tr>
<td>Does the applicant request a conference with the IRS National Office if the IRS proposes an adverse response?</td>
<td>X</td>
<td></td>
</tr>
<tr>
<td>17</td>
<td></td>
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<tr>
<td>If the applicant is changing to either the overall cash method, an overall accrual method, or is changing its method of accounting for any property subject to section 263A, any long-term contract subject to section 460, or inventories subject to section 474, enter the applicant’s gross receipts for the 3 tax years preceding the tax year of change.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1st preceding year ended: mo yr</td>
<td>2nd preceding year ended: mo yr</td>
<td>3rd preceding year ended: mo yr</td>
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<td>$</td>
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</table>

**Part III** Information For Advance Consent Request

<table>
<thead>
<tr>
<th></th>
<th>Yes</th>
<th>No</th>
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<tbody>
<tr>
<td>18</td>
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<tr>
<td>Is the applicant’s requested change described in any revenue procedure, revenue ruling, notice, regulation, or other published guidance as an automatic change request?</td>
<td>If ‘Yes,’ attach an explanation describing why the applicant is submitting its request under advance consent request procedures.</td>
<td></td>
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<td>19</td>
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<tr>
<td>Attach a full explanation of the legal basis supporting the proposed method for the item being changed. Include a detailed and complete description of the facts that explains how the law specifically applies to the applicant’s situation and that demonstrates that the applicant is authorized to use the proposed method. Include all authority (statutes, regulations, published rulings, court cases, etc.) supporting the proposed method. Also, include either a discussion of the contrary authorities or a statement that no contrary authority exists.</td>
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<td>Attach a copy of all documents related to the proposed change (see instructions).</td>
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<td>Attach a statement of the applicant’s reasons for the proposed change.</td>
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<tr>
<td>If the applicant is a member of a consolidated group for the year of change, do all other members of the consolidated group use the proposed method of accounting for the item being changed?</td>
<td>If ‘No,’ attach an explanation.</td>
<td></td>
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<tr>
<td>23a</td>
<td></td>
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<tr>
<td>Enter the amount of user fee attached to this application (see instructions).</td>
<td>b If the applicant qualifies for a reduced user fee, attach the required information or certification (see instructions).</td>
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**Part IV** Section 481(a) Adjustment

<table>
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<tr>
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<th>Yes</th>
<th>No</th>
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<tbody>
<tr>
<td>24</td>
<td></td>
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</tr>
<tr>
<td>Does the applicable revenue procedure, revenue ruling, notice, regulation, or other published guidance require the applicant to implement the requested change in method of accounting on a cut-off basis rather than a section 481(a) adjustment?</td>
<td>If ‘Yes,’ do not complete lines 25, 26, and 27 below.</td>
<td></td>
</tr>
<tr>
<td>25</td>
<td></td>
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</tr>
<tr>
<td>Enter the section 481(a) adjustment. Indicate whether the adjustment is an increase (+) or a decrease (-) in income:</td>
<td>$ -27,250. Attach a summary of the computation and an explanation of the methodology used to determine the section 481(a) adjustment. If it is based on more than one component, show the computation for each component. If more than one applicant is applying for the method change on the same application, attach a list of the name, identification number, principal business activity code (see instructions), and the amount of the section 481(a) adjustment attributable to each applicant.</td>
<td></td>
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</tbody>
</table>

See Attachment 2
Applicants requesting a change to the cash method must attach the following information:

- **Schedule A**
  - Part I: Change in Overall Method
  - Part II: Change to the Cash Method For Advance Consent Request

**Schedule A – Change in Overall Method of Accounting** (If Schedule A applies, Part I below must be completed.)

### Part I: Change in Overall Method (see instructions)

1. Enter the following amounts as of the close of the tax year preceding the year of change. If none, state 'None.' Also, attach a statement providing a breakdown of the amounts entered on lines 1a through 1g.

<table>
<thead>
<tr>
<th>Amount</th>
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</table>

   a. Income accrued but not received.
   b. Income received or reported before it was earned (such as advanced payments). Attach a description of the income and the legal basis for the proposed method.
   c. Expenses accrued but not paid (such as accounts payable).
   d. Prepaid expenses previously deducted.
   e. Supplies on hand previously deducted and/or not previously reported.
   f. Inventory on hand previously deducted and/or not previously reported. Complete Schedule D, Part II.
   g. Other amounts (specify). Attach a description of the item and the legal basis for its inclusion in the calculation of the section 481(a) adjustment.
   h. Net section 481(a) adjustment (Combine lines 1a – 1g.) Indicate whether the adjustment is an increase (+) or decrease (-) in income. Also enter the net amount of this section 481(a) adjustment amount on Part IV, line 25.

2. Is the applicant also requesting the recurring item exception under section 461(h)(3)?
   - Yes
   - No

3. Attach copies of the profit and loss statement (Schedule F (Form 1040) for farmers) and the balance sheet, if applicable, as of the close of the tax year preceding the year of change. Also attach a statement specifying the accounting method used when preparing the balance sheet. If books of account are not kept, attach a copy of the business schedules submitted with the Federal income tax return or other return (e.g., tax-exempt organization returns) for that period. If the amounts in Part I, lines 1a through 1g, do not agree with those shown on both the profit and loss statement and the balance sheet, attach a statement explaining the differences.

### Part II: Change to the Cash Method For Advance Consent Request (see instructions)

Applicants requesting a change to the cash method must attach the following information:

1. A description of inventory items (items whose production, purchase, or sale is an income-producing factor) and materials and supplies used in carrying out the business.
2. An explanation as to whether the applicant is required to use the accrual method under any section of the Code or regulations.

**Schedule B – Change in Reporting Advance Payments (see instructions)**

1. If the applicant is requesting to change to the Deferral Method for advance payments described in section 5.02 of Rev Proc 2004-34, 2004-1 CB 991, attach the following information:
   - a. A statement explaining how the advance payments meet the definition in section 4.01 of Rev Proc 2004-34.
   - b. If the applicant is filing under the automatic change procedures of Rev Proc 2008-52, the information required by section 8.02(3)(a)-(c) of Rev Proc 2004-34.
   - c. If the applicant is filing under the advance consent provisions of Rev Proc 97-27, the information required by section 8.03(2)(a)-(c) of Rev Proc 2004-34.
   - d. A statement explaining the advance payments will be received under the contracts, and how the exception will limit the deferral of income.

2. If the applicant is requesting to change to the deferral method for advance payments described in Regulations section 1.461-5(b)(1)(ii), attach the following:
   a. A statement explaining how the advance payments meet the definition in Regulations section 1.461-5(a)(1).
   b. A statement explaining what portions of the advance payments, if any, are attributable to services, whether such services are integral to the provisions of goods or items, and whether any portions of the advance payments that are attributable to non-integral services are less than five percent of the total contract prices. See Regulations sections 1.461-5(a)(2)(i) and (3).
   c. A statement explaining that the advance payments will be included in income no later than when included in gross receipts for purposes of the applicant's financial reports. See Regulations section 1.461-5(b)(1)(ii).
   d. A statement explaining whether the inventory items exception of Regulations section 1.461-5(c) applies and if so, when substantial advance payments will be received under the contracts, and how the exception will limit the deferral of income.
Schedule C — Changes Within the LIFO Inventory Method (see instructions)

Part I General LIFO Information

Complete this section if the requested change involves changes within the LIFO inventory method. Also, attach a copy of all Forms 970, Application To Use LIFO Inventory Method, filed to adopt or expand the use of the LIFO method.

1. Attach a description of the applicant’s present and proposed LIFO methods and submethods for each of the following items:
   a. Valuing inventory (e.g., unit method or dollar-value method).
   b. Pooling (e.g., by line or type or class of goods, natural business unit, multiple pools, raw material content, simplified dollar-value method, inventory price index computation (IPIC) pools, vehicle-pool method, etc).
   c. Pricing dollar-value pools (e.g., double-extension, index, link-chain, link-chain index, IPIC method, etc).
   d. Determining the current-year cost of goods in the ending inventory (i.e., most recent acquisitions, earliest acquisitions during the current year, average cost of current-year acquisitions, or other permitted method).

2. If any present method or submethod used by the applicant is not the same as indicated on Form(s) 970 filed to adopt or expand the use of the method, attach an explanation.

3. If the proposed change is not requested for all the LIFO inventory, attach a statement specifying the inventory to which the change is and is not applicable.

4. If the proposed change is not requested for all of the LIFO pools, attach a statement specifying the LIFO pool(s) to which the change is applicable.

5. Attach a statement addressing whether the applicant values any of its LIFO inventory on a method other than cost. For example, if the applicant values some of its LIFO inventory at retail and the remainder at cost, identify which inventory items are valued under each method.

6. If changing to the IPIC method, attach a completed Form 970.

Part II Change in Pooling Inventories

1. If the applicant is proposing to change its pooling method or the number of pools, attach a description of the contents of, and state the base year for, each dollar-value pool the applicant presently uses and proposes to use.

2. If the applicant is proposing to use natural business unit (NBU) pools or requesting to change the number of NBU pools, attach the following information (to the extent not already provided) in sufficient detail to show that each proposed NBU was determined under Regulations section 1.472-8(b)(1) and (2):
   a. A description of the types of products produced by the applicant. If possible, attach a brochure.
   b. A description of the types of processes and raw materials used to produce the products in each proposed pool.
   c. If all of the products to be included in the proposed NBU pool(s) are not produced at one facility, state the reasons for the separate facilities, the location of each facility, and a description of the products each facility produces.
   d. A description of the natural business divisions adopted by the taxpayer. State whether separate cost centers are maintained and if separate profit and loss statements are prepared.
   e. A statement addressing whether the applicant has inventories of items purchased and held for resale that are not further processed by the applicant, including whether such items, if any, will be included in any proposed NBU pool.
   f. A statement addressing whether all items including raw materials, goods-in-process, and finished goods entering into the entire inventory investment for each proposed NBU pool are presently valued under the LIFO method. Describe any items that are not presently valued under the LIFO method that are to be included in each proposed pool.
   g. A statement addressing whether, within the proposed NBU pool(s), there are items both sold to unrelated parties and transferred to a different unit of the applicant to be used as a component part of another product prior to final processing.

3. If the applicant is engaged in manufacturing and is proposing to use the multiple pooling method or raw material content pools, attach information to show that each proposed pool will consist of a group of items that are substantially similar. See Regulations section 1.472-8(b)(3).

4. If the applicant is engaged in the wholesaling or retailing of goods and is requesting to change the number of pools used, attach information to show that each of the proposed pools is based on customary business classifications of the applicant’s trade or business. See Regulations section 1.472-8(c).
**Schedule D — Change in Reporting Income From Long-Term Contracts Under Section 460, Inventories, or Other Section 263A Assets (see instructions)**

### Part I | Change in Reporting Income From Long-Term Contracts

(Also complete Part III on pages 7 and 8.)

1. To the extent not already provided, attach a description of the applicant's present and proposed methods for reporting income and expenses from long-term contracts. Also, attach a representative actual contract (without any deletion) for the requested change. If the applicant is a construction contractor, attach a detailed description of its construction activities.

2. **a** Are the applicant's contracts long-term contracts as defined in section 460(f)(1) (see instructions)?
   - Yes
   - No

3. **a** Does the applicant have long-term manufacturing contracts as defined in section 460(f)(2)?
   - Yes
   - No

4. To determine a contract's completion factor using the percentage-of-completion method:
   - Will the applicant use the cost-to-cost method in Regulations section 1.460-4(b)?
   - Yes
   - No

5. Attach a statement indicating whether any of the applicant's contracts are either cost-plus long-term contracts or Federal manufacturing contracts.

### Part II | Change in Valuing Inventories Including Cost Allocation Changes

(Also complete Part III on pages 7 and 8.)

1. Attach a description of the inventory goods being changed.

2. Attach a description of the inventory goods (if any) NOT being changed.

3. **a** Is the applicant subject to section 263A? If 'No,' go to line 4a.
   - Yes
   - No

4. **a** Check the appropriate boxes below.

   **Identification methods:**
   - Specific identification
   - FIFO
   - LIFO
   - Other (attach explanation)

   **Valuation methods:**
   - Cost
   - Cost or market, whichever is lower
   - Retail cost
   - Retail, lower of cost or market
   - Other (attach explanation)

5. If the applicant is changing from the LIFO inventory method to a non-LIFO method, attach the following information. (see instructions).

   **a** Copies of Form(s) 970 filed to adopt or expand the use of the method.

   **b** Only for applicants requesting advance consent. A statement describing whether the applicant is changing to the method required by Regulations section 1.472-6(a) or (b), or whether the applicant is proposing a different method.

   **c** Only for applicants requesting an automatic change. The statement required by section 22.01(5) of the Appendix of Rev Proc 2008-52 (or its successor).
### Section A – Allocation and Capitalization Methods

Attach a description (including sample computations) of the present and proposed method(s) the applicant uses to capitalize direct and indirect costs properly allocable to real or tangible personal property produced and property acquired for resale, or to allocate and, where appropriate, capitalize direct and indirect costs properly allocable to long-term contracts. Include a description of the method(s) used for allocating indirect costs to intermediate cost objectives such as departments or activities prior to the allocation of such costs to long-term contracts, real or tangible personal property produced, and property acquired for resale. The description must include the following:

1. The method of allocating direct and indirect costs (i.e., specific identification, burden rate, standard cost, or other reasonable allocation method).
2. The method of allocating mixed service costs (i.e., direct reallocation, step-allocation, simplified service cost using the labor-based allocation ratio, simplified service cost using the production cost allocation ratio, or other reasonable allocation method).
3. The method of capitalizing additional section 263A costs (i.e., simplified production with or without the historic absorption ratio election, simplified resale with or without the historic absorption ratio election including permissible variations, the U.S. ratio, or other reasonable allocation method).

### Section B – Direct and Indirect Costs Required To Be Allocated

Check the appropriate boxes showing the costs that are or will be fully included, to the extent required, in the cost of real or tangible personal property produced or property acquired for resale under section 263A or allocated to long-term contracts under section 460. Mark 'N/A' in a box if those costs are not incurred by the applicant. If a box is not checked, it is assumed that those costs are not fully included to the extent required. Attach an explanation for boxes that are not checked.

<table>
<thead>
<tr>
<th>Present method</th>
<th>Proposed method</th>
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</thead>
<tbody>
<tr>
<td>1 Direct material</td>
<td></td>
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<tr>
<td>2 Direct labor</td>
<td></td>
</tr>
<tr>
<td>3 Indirect labor</td>
<td></td>
</tr>
<tr>
<td>4 Officers’ compensation (not including selling activities)</td>
<td></td>
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<tr>
<td>5 Pension and other related costs</td>
<td></td>
</tr>
<tr>
<td>6 Employee benefits</td>
<td></td>
</tr>
<tr>
<td>7 Indirect materials and supplies</td>
<td></td>
</tr>
<tr>
<td>8 Purchasing costs</td>
<td></td>
</tr>
<tr>
<td>9 Handling, processing, assembly, and repackaging costs</td>
<td></td>
</tr>
<tr>
<td>10 Offsite storage and warehousing costs</td>
<td></td>
</tr>
<tr>
<td>11 Depreciation, amortization, and cost recovery allowance for equipment and facilities placed in service and not temporarily idle</td>
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<tr>
<td>12 Depletion</td>
<td></td>
</tr>
<tr>
<td>13 Rent</td>
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<tr>
<td>14 Taxes other than state, local, and foreign income taxes</td>
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<tr>
<td>15 Insurance</td>
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<td>16 Utilities</td>
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<tr>
<td>17 Maintenance and repairs that relate to a production, resale, or long-term contract activity</td>
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<tr>
<td>18 Engineering and design costs (not including section 174 research and experimental expenses)</td>
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<tr>
<td>19 Rework labor, scrap, and spoilage</td>
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<tr>
<td>20 Tools and equipment</td>
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<tr>
<td>21 Quality control and inspection</td>
<td></td>
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<tr>
<td>22 Bidding expenses incurred in the solicitation of contracts awarded to the applicant</td>
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<tr>
<td>23 Licensing and franchise costs</td>
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<tr>
<td>24 Capitalizable service costs (including mixed service costs)</td>
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<tr>
<td>25 Administrative costs (not including any costs of selling or any return on capital)</td>
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<tr>
<td>26 Research and experimental expenses attributable to long-term contracts</td>
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<tr>
<td>27 Interest</td>
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<tr>
<td>28 Other costs (Attach a list of these costs)</td>
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</tbody>
</table>
**Schedule E — Change in Depreciation or Amortization (see instructions)**

Applicants requesting approval to change their method of accounting for depreciation or amortization complete this section. Applicants must provide this information for each item or class of property for which a change is requested.

Note: See the List of Automatic Accounting Method Changes in the instructions for information regarding automatic changes under sections 56, 167, 168, 1400I, 1400L, or former section 168. Do not file Form 3115 with respect to certain late elections and election revocations (see instructions).

1. Is depreciation for the property determined under Regulations section 1.167(a)-11 (CLADR)?
   - Yes
   - No

2. Is any of the depreciation or amortization required to be capitalized under any Code section (e.g., section 263A)?
   - Yes
   - No

3. Has a depreciation, amortization, or expense election been made for the property (e.g., the election under section 168(f)(1), 179, or 179C)?
   - Yes
   - No

4a. To the extent not already provided, attach a statement describing the property being changed. Include in the description the type of property, the year the property was placed in service, and the property's use in the applicant's trade or business or income-producing activity.
   - Yes
   - No

4b. If the property is residential rental property, did the applicant live in the property before renting it?
   - Yes
   - No

4c. Is the property public utility property?
   - Yes
   - No

5. To the extent not already provided in the applicant's description of its present method, attach a statement explaining how the property is treated under the applicant's present method (e.g., depreciable property, inventory property, supplies under Regulations section 1.162-3, nondepreciable section 263(a) property, property deductible as a current expense, etc).

6. If the property is not currently treated as depreciable or amortizable property, attach a statement of the facts supporting the proposed change to deprecate or amortize the property.

7. If the property is currently treated and/or will be treated as depreciable or amortizable property, the following information for both the present (if applicable) and proposed methods:
   - a. The Code section under which the property is or will be depreciated or amortized (e.g., section 168(g)).
   - b. The applicable asset class from Rev Proc 87-56, 1987-2 CB 674, for each asset depreciated under section 168 (MACRS) or under section 1400L; the applicable asset class from Rev Proc 83-35, 1983-1 CB 745, for each asset depreciated under former section 168 (ACRS); an explanation why no asset class is identified for each asset for which an asset class has not been identified by the applicant.
   - c. The facts to support the asset class for the proposed method.
   - d. The depreciation or amortization method of the property, including the applicable Code section (e.g., 200% declining balance method under section 168(b)(1)).
   - e. The useful life, recovery period, or amortization period of the property.
   - f. The applicable convention of the property.
   - g. A statement of whether or not the additional first-year special depreciation allowance (for example, as provided by section 168(k), 168(l), 168(m), 168(n), 1400L(b), or 1400N(d)) was or will be claimed for the property. If not, also provide an explanation as to why no special depreciation allowance was or will be claimed.
Attachment 1
Form 3115, Part II, Line 12
Description of Item When Overall Method of Accounting Is Not Being Changed, or When Overall Method is Being Changed and Also Changing to a Special Method

Item being changed:
DCN 205: Adoption of Treas. Regs. Section 1.168(i)-8 regarding dispositions of a building or structural components.
DCN 206: Adoption of Treas. Regs. Section 1.168(i)-8 regarding dispositions of tangible depreciable assets (other than a building or its structural components).

Present method:
DCN 205: The taxpayer's current method of accounting for dispositions of a building or its structural components does not provide for recognizing gain or loss on a disposition of less than the entire unit of property.
DCN 206: The taxpayer's current method of accounting for dispositions of tangible depreciable assets (other than a building or its structural components) does not provide for recognizing gain or loss on a disposition of less than the entire unit of property.

Proposed method:
DCN 205: The taxpayer has adopted the method of accounting for dispositions of a building or its structural components under Treas. Regs. Section 1.168(i)-8 as modified by TD 9689.
DCN 206: The taxpayer has adopted the method of accounting for dispositions of tangible depreciable assets (other than a building or its structural components) under Treas. Regs. Section 1.168(i)-8 as modified by TD 9689.

Present overall accounting method: Cash

Attachment 2
Form 3115, Part IV, Line 25
Methodology Used to Determine the Section 481(a) Adjustment

DCN 205: $(26,000) In 2009 the taxpayer replaced a roof damaged during an earthquake at a cost of $39,000. No loss was recognized and the original roof continued to be depreciated. The cost of the new roof was capitalized and has been depreciated since 2009. The original cost of the replaced roof was determined by discounting the cost of the new roof using the Producer Price Index for Final Demand.

Basis of original roof $34,000
Accumulated depreciation as of December 31, 2013 (8,000)
-------
Adjusted basis as of December 31, 2013 $26,000

DCN 206: $(1,250) In 2012 the taxpayer replaced two clothes dryers (included in a bank of ten dryers) that were destroyed in a fire. The cost of the original ten clothes dryer-bank was $20,000. Allocated basis of the two destroyed dryers is $4,000 (2/10 of the original cost of the entire clothes dryer bank). No loss was recognized and the original clothes dryer bank continued to be depreciated. The cost of the new dryers was capitalized and has been depreciated since 2012.
Methodology Used to Determine the Section 481(a) Adjustment

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Basis of two clothes dryers</td>
<td>$ 4,000</td>
</tr>
<tr>
<td>Accumulated depreciation as of December</td>
<td>(2,750)</td>
</tr>
<tr>
<td>31, 2013</td>
<td></td>
</tr>
<tr>
<td>Adjusted basis as of December 31, 2013</td>
<td>$ 1,250</td>
</tr>
</tbody>
</table>

Summary:
- DCN 205 Section 481(a) adjustment     $ (26,000)
- DCN 206 Section 481(a) adjustment     (1,250)

Net Section 481(a) adjustment           $ (27,250)
Fluffit Company operates a uniform and linen rental business, utilizing two assembly lines to treat, launder, and prepare rental items for its customers. Each assembly line is plant property that is comprised of a sorter, boiler, washer, dryer, ironer, folder, and waste water treatment system. Fluffit has previously treated each assembly line as a single unit of property. Fluffit is adopting the TPR definitions of unit of property as it applies to plant property. Average annual gross receipts for the last three years have been less than $10 million.

Fluffit is adopting the TPRs method of accounting for materials and supplies under Treas. Regs. §1.162-3, and for repairs under Treas. Regs. §1.162-4. Fluffit is also adopting the TPRs method of account for definitions of unit of property, determination of capital expenditure, capitalization of acquisition costs, and capitalization of improvements contained in Treas. Regs. §1.263(a)-1, §1.263(a)-2, and §1.263(a)-3. None of the changes will result in any IRC §481(a) adjustments.
Form 3115
Application for Change in Accounting Method

Name of filer (name of parent corporation if a consolidated group) (see instructions)
FLUFFIT COMPANY
Identification number (see instructions)
33-3333333
Principal business activity code number (see instructions)
812330
Number, street, and room or suite no. If a P.O. box, see the instructions.
12345 ANY STREET
Tax year of change begins (MM/DD/YYYY)
1/01/2014
Tax year of change ends (MM/DD/YYYY)
12/31/2014
City or town, state, and ZIP code
EVERYTOWN, CA 99999
Name of contact person (see instructions)
AMY FOLDER
Name of applicant(s) (if different than filer) and identification number(s) (see instructions)
Contact person's telephone number

If the applicant is a member of a consolidated group, check this box

If Form 2848, Power of Attorney and Declaration of Representative, is attached (see instructions for when Form 2848 is required), check this box

Check the box to indicate the applicant.

Individual
Cooperative (Section 1381)
X

Check the appropriate box to indicate the type of accounting method change being requested.

Depreciation or Amortization
Financial Products and/or Financial Activities of
Financial Institutions

G

X

Other (specify)...

X

AUTOMATIC CHANGE REQUEST (MULTIPLE)

Caution.

Part I Information For Automatic Change Request

Yes No

1 requested change has no designated automatic accounting method change number, check 'Other,' and provide both a description of the change and citation of the IRS guidance providing the automatic change. See instructions.

(a) Change No. (b) Other Description

X 184, 186, 187, 192

2 the applicant's requested change? If 'Yes,' attach an explanation

Note. Complete Part II below and then Part IV, and also Schedules A through E of this form (if applicable).

Part II Information for All Requests

Yes No

3 Did or will the applicant cease to engage in the trade or business to which the requested change relates, or terminate its existence, in the tax year of change (see instructions)?

X

4a Does the applicant (or any present or former consolidated group in which the applicant was a member during the applicable tax year(s)) have any Federal income tax return(s) under examination (see instructions)?

X

b or former consolidated group in which the applicant was a member during the applicable tax year(s)) either (i) under consideration or (ii) placed in suspense (see instructions)?

Signature (see instructions)

Filer
Preparer (other than filer/applicant)

AMY FOLDER, PRESIDENT
X

Seid & Company, CPAs
935 Riverside Avenue, Suite 1
Paso Robles, CA 93446

BAA For Privacy Act and Paperwork Reduction Act Notice, see the instructions.
Part II Information For All Requests (continued)

4c Is the method of accounting the applicant is requesting to change an issue pending (with respect to either the applicant or any present or former consolidated group in which the applicant was a member during the applicable tax year(s)) for any tax year under examination (see instructions)?

4d Is the request to change the method of accounting being filed under the procedures requiring that the operating division director consent to the filing of the request (see instructions)?

If 'Yes,' attach the consent statement from the director.

4e Is the request to change the method of accounting being filed under the 90-day or 120-day window period?

If 'Yes,' check the box for the applicable window period and attach the required statement (see instructions).

   90 day [ ]
   120 day: Date examination ended [ ]

4f If you answered 'Yes' to line 4a, enter the name and telephone number of the examining agent and the tax year(s) under examination.

   Name [ ]
   Telephone number [ ]
   Tax year(s) [ ]

4g Has a copy of this Form 3115 been provided to the examining agent identified on line 4f? [ ]

5a Does the applicant (or any present or former consolidated group in which the applicant was a member during the applicable tax year(s)) have any Federal income tax return(s) before Appeals and/or a Federal court?

If 'Yes,' enter the name of the (check the box) [ ] Appeals officer and/or [ ] counsel for the government, and the tax year(s) before Appeals and/or a Federal court.

   Name [ ]
   Telephone number [ ]
   Tax year(s) [ ]

5b Has a copy of this Form 3115 been provided to the Appeals officer and/or counsel for the government identified on line 5a?

5c Is the method of accounting the applicant is requesting to change an issue under consideration by Appeals and/or a Federal court (for either the applicant or any present or former consolidated group in which the applicant was a member for the tax year(s) the applicant was a member) (see instructions)?

If 'Yes,' attach an explanation.

5d If the applicant answered 'Yes' to line 4a and/or 5a with respect to any present or former consolidated group, attach a statement that provides each parent corporation's (a) name, (b) identification number, (c) address, and (d) tax year(s) during which the applicant was a member that is under examination, before an Appeals office, and/or before a Federal court.

7 If, for federal income tax purposes, the applicant is either an entity (including a limited liability company) treated as a partnership or an S corporation, is it requesting a change from a method of accounting that is an issue under consideration in an examination, before Appeals, or before a Federal court, with respect to a Federal income tax return of a partner, member, or shareholder of that entity? [ ]

If 'Yes,' the applicant is not eligible to make the change.

8a Does the applicable revenue procedure (advance consent or automatic consent) state that the applicant does not receive audit protection for the requested change (see instructions)?

8b If 'Yes,' attach an explanation.

9a Has the applicant, its predecessor, or a related party requested or made (under either an automatic change procedure or a procedure requiring advance consent) a change in method of accounting within the past 5 years (including the year of the requested change)?

9b If 'Yes,' for each trade or business, attach a description of each requested change in method of accounting (including the tax year of change) and state whether the applicant received consent.

9c If any application was withdrawn, not perfected, or denied, or if a Consent Agreement granting a change was sent to the taxpayer but was not signed and returned to the IRS, or if the change was not made or not made in the requested year of change, attach an explanation.

10a Does the applicant, its predecessor, or a related party currently have pending any request (including any concurrently filed request) for a private letter ruling, change in method of accounting, or technical advice?

10b If 'Yes,' for each request attach a statement providing the name(s) of the taxpayer, identification number(s), the type of request (private letter ruling, change in method of accounting, or technical advice), and the specific issue(s) in the request(s).

11 Is the applicant requesting to change its overall method of accounting?

If 'Yes,' check the appropriate boxes below to indicate the applicant's present and proposed methods of accounting. Also, complete Schedule A on page 4 of this form.

Present method: [ ] Cash [ ] Accrual [ ] Hybrid (attach description)

Proposed method: [ ] Cash [ ] Accrual [ ] Hybrid (attach description)
**Form 3115 (Rev 12-2009) FLUFFIT COMPANY 33-3333333 Page 3**

### Part II | Information For All Requests (continued)

<table>
<thead>
<tr>
<th></th>
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<th>No</th>
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<td>c</td>
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<tr>
<td>d</td>
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</table>

### Part III | Information For Advance Consent Request

<table>
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<th>No</th>
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<tbody>
<tr>
<td>18</td>
<td></td>
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</table>

If 'Yes,' attach an explanation describing why the applicant is submitting its request under advance consent request procedures.

### Part IV | Section 481(a) Adjustment

<table>
<thead>
<tr>
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<th>Yes</th>
<th>No</th>
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<tbody>
<tr>
<td>24</td>
<td></td>
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</tbody>
</table>

If 'Yes,' enter the amount of user fee attached to this application (see instructions).

### Part IV | Section 481(a) Adjustment (continued)

<table>
<thead>
<tr>
<th></th>
<th>Yes</th>
<th>No</th>
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<tbody>
<tr>
<td>25</td>
<td></td>
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</tbody>
</table>

Attach a summary of the computation and an explanation of the methodology used to determine the section 481(a) adjustment. If it is based on more than one component, show the computation for each component. If more than one applicant is applying for the method change on the same application, attach a list of the name, identification number, principal business activity code (see instructions), and the amount of the section 481(a) adjustment attributable to each applicant.

See Attachment 3
Applicants requesting a change to the cash method must attach the following information:

**Schedule A – Change in Overall Method of Accounting** (If Schedule A applies, Part I below must be completed.)

**Part I  Change in Overall Method (see instructions)**

1. Enter the following amounts as of the close of the tax year preceding the year of change. If none, state 'None.' Also, attach a statement providing a breakdown of the amounts entered on lines 1a through 1g.

   a. Income accrued but not received.
   b. Income received or reported before it was earned (such as advanced payments). Attach a description of the income and the legal basis for the proposed method.
   c. Expenses accrued but not paid (such as accounts payable).
   d. Prepaid expenses previously deducted.
   e. Supplies on hand previously deducted and/or not previously reported.
   f. Inventory on hand previously deducted and/or not previously reported. Complete Schedule D, Part II.
   g. Other amounts (specify). Attach a description of the item and the legal basis for its inclusion in the calculation of the section 481(a) adjustment.
   h. Net section 481(a) adjustment. Indicate whether the adjustment is an increase (+) or decrease (-) in income. Also enter the net amount of this section 481(a) adjustment amount on Part IV, line 25.

2. Is the applicant also requesting the recurring item exception under section 461(h)(3)?

   Yes  No

3. Attach copies of the profit and loss statement (Schedule F (Form 1040) for farmers) and the balance sheet, if applicable, as of the close of the tax year preceding the year of change. Also, attach a statement specifying the accounting method used when preparing the balance sheet. If books of account are not kept, attach a copy of the business schedules submitted with the Federal income tax return or other return (e.g., tax-exempt organization returns) for that period. If the amounts in Part I, lines 1a through 1g, do not agree with those shown on both the profit and loss statement and the balance sheet, attach a statement explaining the differences.

**Part II  Change to the Cash Method For Advance Consent Request** (see instructions)

Applicants requesting a change to the cash method must attach the following information:

1. A description of inventory items (items whose production, purchase, or sale is an income-producing factor) and materials and supplies used in carrying out the business.

2. An explanation as to whether the applicant is required to use the accrual method under any section of the Code or regulations.

**Schedule B – Change in Reporting Advance Payments** (see instructions)

1. If the applicant is requesting to change to the Deferral Method for advance payments described in section 5.02 of Rev Pro 2004-34, 2004-1 CB 991, attach the following information:
   a. A statement explaining how the advance payments meet the definition in section 4.01 of Rev Pro 2004-34.
   b. If the applicant is filing under the automatic change procedures of Rev Proc 2008-52, the information required by section 8.02(3)(a)-(c) of Rev Pro 2004-34.
   c. If the applicant is filing under the advance consent provisions of Rev Proc 2004-34, attach the following:
      a. A statement explaining how the advance payments meet the definition in section 4.01(11)(ii) of Rev Pro 2004-34.
      b. A statement explaining what portions of the advance payments, if any, are attributable to services, whether such services are integral to the provisions of goods or items, and whether any portions of the advance payments that are attributable to non-integral services are less than five percent of the total contract prices. See Regulations section 1.451-5(a)(3). 
      c. A statement explaining that the advance payments will be included in income no later than when included in gross receipts for purposes of the applicant’s financial reports. See Regulations section 1.451-5(b)(1)(ii).
      d. A statement explaining whether the inventoryable goods exception of Regulations section 1.451-5(c) applies and if so, when substantial advance payments will be received under the contracts, and how the exception will limit the deferral of income.
Schedule C — Changes Within the LIFO Inventory Method (see instructions)

Part I General LIFO Information

Complete this section if the requested change involves changes within the LIFO inventory method. Also, attach a copy of all Forms 970, Application To Use LIFO Inventory Method, filed to adopt or expand the use of the LIFO method.

1. Attach a description of the applicant’s present and proposed LIFO methods and submethods for each of the following items:
   a. Valuing inventory (e.g., unit method or dollar-value method).
   b. Pooling (e.g., by line or type or class of goods, natural business unit, multiple pools, raw material content, simplified dollar-value method, inventory price index computation (IPIC) pools, vehicle-pool method, etc).
   c. Pricing dollar-value pools (e.g., double-extension, index, link-chain, link-chain index, IPIC method, etc).
   d. Determining the current-year cost of goods in the ending inventory (i.e., most recent acquisitions, earliest acquisitions during the current year, average cost of current-year acquisitions, or other permitted method).

2. If any present method or submethod used by the applicant is not the same as indicated on Form(s) 970 filed to adopt or expand the use of the method, attach an explanation.

3. If the proposed change is not requested for all the LIFO inventory, attach a statement specifying the inventory to which the change is and is not applicable.

4. If the proposed change is not requested for all of the LIFO pools, attach a statement specifying the LIFO pool(s) to which the change is applicable.

5. Attach a statement addressing whether the applicant values any of its LIFO inventory on a method other than cost. For example, if the applicant values some of its LIFO inventory at retail and the remainder at cost, identify which inventory items are valued under each method.

6. If changing to the IPIC method, attach a completed Form 970.

Part II Change in Pooling Inventories

1. If the applicant is proposing to change its pooling method or the number of pools, attach a description of the contents of, and state the base year for, each dollar-value pool the applicant presently uses and proposes to use.

2. If the applicant is proposing to use natural business unit (NBU) pools or requesting to change the number of NBU pools, attach the following information (to the extent not already provided) in sufficient detail to show that each proposed NBU was determined under Regulations section 1.472-8(b)(1) and (2):
   a. A description of the types of products produced by the applicant. If possible, attach a brochure.
   b. A description of the types of processes and raw materials used to produce the products in each proposed pool.
   c. If all of the products to be included in the proposed NBU pool(s) are not produced at one facility, state the reasons for the separate facilities, the location of each facility, and a description of the products each facility produces.
   d. A description of the natural business divisions adopted by the taxpayer. State whether separate cost centers are maintained and if separate profit and loss statements are prepared.
   e. A statement addressing whether the applicant has inventories of items purchased and held for resale that are not further processed by the applicant, including whether such items, if any, will be included in any proposed NBU pool.
   f. A statement addressing whether all items including raw materials, goods-in-process, and finished goods entering into the entire inventory investment for each proposed NBU pool are presently valued under the LIFO method. Describe any items that are not presently valued under the LIFO method that are to be included in each proposed pool.
   g. A statement addressing whether, within the proposed NBU pool(s), there are items both sold to unrelated parties and transferred to a different unit of the applicant to be used as a component part of another product prior to final processing.

3. If the applicant is engaged in manufacturing and is proposing to use the multiple pooling method or raw material content pools, attach information to show that each proposed pool will consist of a group of items that are substantially similar. See Regulations section 1.472-8(b)(3).

4. If the applicant is engaged in the wholesaling or retailing of goods and is requesting to change the number of pools used, attach information to show that each of the proposed pools is based on customary business classifications of the applicant’s trade or business. See Regulations section 1.472-8(c).
Schedule D — Change in the Treatment of Long-Term Contracts Under Section 460, Inventories, or Other Section 263A Assets (see instructions)

Part I Change in Reporting Income From Long-Term Contracts (Also complete Part III on pages 7 and 8.)

1 To the extent not already provided, attach a description of the applicant's present and proposed methods for reporting income and expenses from long-term contracts. Also, attach a representative actual contract (without any deletion) for the requested change. If the applicant is a construction contractor, attach a detailed description of its construction activities.

2a Are the applicant's contracts long-term contracts as defined in section 460(f)(1) (see instructions)?
   Yes  No

b If 'Yes,' do all the contracts qualify for the exception under section 460(e) (see instructions)?
   Yes  No

   If line 2b is 'No,' attach an explanation.

c If line 2b is 'Yes,' the applicant requesting to use the percentage-of-completion method using cost-to-cost under Regulations section 1.460-4(b)?
   Yes  No

d If line 2c is 'No,' the applicant requesting to use the exempt-contract percentage-of-completion method under Regulations section 1.460-4(c)(2)?
   Yes  No

   If line 2d is 'Yes,' attach an explanation of what cost comparison the applicant will use to determine a contract's completion factor.

   If line 2d is 'No,' attach an explanation of what method the applicant is using and the authority for its use.

3a Does the applicant have long-term manufacturing contracts as defined in section 460(f)(2)?
   Yes  No

b If 'Yes,' attach an explanation of the applicant's present and proposed method(s) of accounting for long-term manufacturing contracts.

   c Attach a description of the applicant's manufacturing activities, including any required installation of manufactured goods.

4 To determine a contract's completion factor using the percentage-of-completion method:

a Will the applicant use the cost-to-cost method in Regulations section 1.460-4(b)?
   Yes  No

b If line 4a is 'No,' is the applicant selecting the simplified cost-to-cost method (see section 460(b)(3) and Regulations section 1.460-5(c))? 
   Yes  No

5 Attach a statement indicating whether any of the applicant's contracts are either cost-plus long-term contracts or Federal long-term contracts.

Part II Change in Valuing Inventories Including Cost Allocation Changes (Also complete Part III on pages 7 and 8.)

1 Attach a description of the inventory goods being changed.

2 Attach a description of the inventory goods (if any) NOT being changed.

3a Is the applicant subject to section 263A? If 'No,' go to line 4a.
   Yes  No

   b Is the applicant's present inventory valuation method in compliance with section 263A (see instructions): 
   Yes  No

   If 'No,' attach a detailed explanation.

4a Check the appropriate boxes below.

   Identification methods:
   Specific identification
   FIFO
   LIFO
   Other (attach explanation)

   Valuation methods:
   Cost
   Cost or market, whichever is lower
   Retail cost
   Retail, lower of cost or market
   Other (attach explanation)

   If the applicant is changing from the LIFO inventory method to a non-LIFO method, attach the following information. (see instructions).

   a Copies of Form(s) 970 filed to adopt or expand the use of the method.

   b Only for applicants requesting advance consent. A statement describing whether the applicant is changing to the method required by Regulations section 1.472-6(a) or (b), or whether the applicant is proposing a different method.

   c Only for applicants requesting an automatic change. The statement required by section 22.01(5) of the Appendix of Rev Proc 2008-52 (or its successor).

   Inventory Being Changed
   Present method
   Proposed method
   Inventory Not Being Changed
   Present method
### Part III  Method of Cost Allocation

(Complete this part if the requested change involves either property subject to section 263A or long-term contracts as described in section 460 (see the instructions).)

#### Section A — Allocation and Capitalization Methods

Attach a description (including sample computations) of the present and proposed method(s) the applicant uses to capitalize direct and indirect costs properly allocable to real or tangible personal property produced and property acquired for resale, or to allocate and, where appropriate, capitalize direct and indirect costs properly allocable to long-term contracts. Include a description of the method(s) used for allocating indirect costs to intermediate cost objectives such as departments or activities prior to the allocation of such costs to long-term contracts, real or tangible personal property produced, and property acquired for resale. The description must include the following:

1. The method of allocating direct and indirect costs (i.e., specific identification, burden rate, standard cost, or other reasonable allocation method).
2. The method of allocating mixed service costs (i.e., direct reallocation, step-allocation, simplified service cost using the labor-based allocation ratio, simplified service cost using the production cost allocation ratio, or other reasonable allocation method).
3. The method of capitalizing additional section 263A costs (i.e., simplified production with or without the historic absorption ratio election, simplified resale with or without the historic absorption ratio election including permissible variations, the U.S. ratio, or other reasonable allocation method).

#### Section B — Direct and Indirect Costs Required To Be Allocated

Check the appropriate boxes showing the costs that are or will be fully included, to the extent required, in the cost of real or tangible personal property produced or property acquired for resale under section 263A or allocated to long-term contracts under section 460. Mark ‘N/A’ in a box if those costs are not incurred by the applicant. If a box is not checked, it is assumed that those costs are not fully included to the extent required. Attach an explanation for boxes that are not checked.

<table>
<thead>
<tr>
<th>Present method</th>
<th>Proposed method</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Direct material</td>
<td></td>
</tr>
<tr>
<td>2 Direct labor</td>
<td></td>
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<tr>
<td>3 Indirect labor</td>
<td></td>
</tr>
<tr>
<td>4 Officers’ compensation</td>
<td></td>
</tr>
<tr>
<td>5 Pension and other related costs</td>
<td></td>
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<td>6 Employee benefits</td>
<td></td>
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<tr>
<td>7 Indirect materials and supplies</td>
<td></td>
</tr>
<tr>
<td>8 Purchasing costs</td>
<td></td>
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<tr>
<td>9 Handling, processing, assembly, and repackaging costs</td>
<td></td>
</tr>
<tr>
<td>10 Offsite storage and warehousing costs</td>
<td></td>
</tr>
<tr>
<td>11 Depreciation, amortization, and cost recovery allowance</td>
<td></td>
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<tr>
<td>12 Depletion</td>
<td></td>
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<tr>
<td>13 Rent</td>
<td></td>
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<tr>
<td>14 Taxes other than state, local, and foreign income taxes</td>
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<tr>
<td>15 Insurance</td>
<td></td>
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<tr>
<td>16 Utilities</td>
<td></td>
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<tr>
<td>17 Maintenance and repairs related to a production, resale, or long-term contract activity</td>
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</tr>
<tr>
<td>18 Engineering and design costs</td>
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</tr>
<tr>
<td>19 Rework labor, scrap, and spoilage</td>
<td></td>
</tr>
<tr>
<td>20 Tools and equipment</td>
<td></td>
</tr>
<tr>
<td>21 Quality control and inspection</td>
<td></td>
</tr>
<tr>
<td>22 Bidding expenses incurred in the solicitation of contracts awarded to the applicant</td>
<td></td>
</tr>
<tr>
<td>23 Licensing and franchise costs</td>
<td></td>
</tr>
<tr>
<td>24 Capitalizable service costs (including mixed service costs)</td>
<td></td>
</tr>
<tr>
<td>25 Administrative costs (not including any costs of selling or any return on capital)</td>
<td></td>
</tr>
<tr>
<td>26 Research and experimental expenses attributable to long-term contracts</td>
<td></td>
</tr>
<tr>
<td>27 Interest</td>
<td></td>
</tr>
<tr>
<td>28 Other costs (Attach a list of these costs)</td>
<td></td>
</tr>
</tbody>
</table>

BAA

Form 3115 (Rev 12-2009)
Part III | Method of Cost Allocation (see instructions) (continued)

Section C — Other Costs Not Required To Be Allocated (Complete Section C only if the applicant is requesting to change its method for these costs.)

<table>
<thead>
<tr>
<th></th>
<th>Present method</th>
<th>Proposed method</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Marketing, selling, advertising, and distribution expenses.</td>
<td></td>
</tr>
<tr>
<td>2</td>
<td>Research and experimental expenses not included in Section B, line 26.</td>
<td></td>
</tr>
<tr>
<td>3</td>
<td>Bidding expenses not included in Section B, line 22.</td>
<td></td>
</tr>
<tr>
<td>4</td>
<td>General and administrative costs not included in Section B.</td>
<td></td>
</tr>
<tr>
<td>5</td>
<td>Income taxes.</td>
<td></td>
</tr>
<tr>
<td>6</td>
<td>Cost of strikes.</td>
<td></td>
</tr>
<tr>
<td>7</td>
<td>Warranty and product liability costs</td>
<td></td>
</tr>
<tr>
<td>8</td>
<td>Section 179 costs.</td>
<td></td>
</tr>
<tr>
<td>9</td>
<td>On-site storage.</td>
<td></td>
</tr>
<tr>
<td>10</td>
<td>Depreciation, amortization, and cost recovery allowance not included in Section B, line 11.</td>
<td></td>
</tr>
<tr>
<td>11</td>
<td>Other costs (Attach a list of these costs.)</td>
<td></td>
</tr>
</tbody>
</table>

Schedule E — Change in Depreciation or Amortization (see instructions)

Applicants requesting approval to change their method of accounting for depreciation or amortization complete this section. Applicants must provide this information for each item or class of property for which a change is requested.

Note: See the List of Automatic Accounting Method Changes in the instructions for information regarding automatic changes under sections 56, 167, 168, 197, 1400I, 1400L, or former section 168. Do not file Form 3115 with respect to certain late elections and election revocations (see instructions).

1 Is depreciation for the property determined under Regulations section 1.167(a)-11 (CLADR)?
   - Yes
   - No
   If 'Yes,' the only changes permitted are under Regulations section 1.167(a)-11(c)(1)(iii).

2 Is any of the depreciation or amortization required to be capitalized under any Code section (e.g., section 263A)?
   - Yes
   - No
   If 'Yes,' enter the applicable section.

3 Has a depreciation, amortization, or expense election been made for the property (e.g., the election under section 168(f)(1), 179, or 179C)?
   - Yes
   - No
   If 'Yes,' state the election made.

4a To the extent not already provided, attach a statement describing the property being changed. Include in the description the type of property, the year the property was placed in service, and the property's use in the applicant's trade or business or income-producing activity.
   - Yes
   - No

4b If the property is residential rental property, did the applicant live in the property before renting it?
   - Yes
   - No

4c Is the property public utility property?
   - Yes
   - No

5 To the extent not already provided in the applicant's description of its present method, attach a statement explaining how the property is treated under the applicant's present method (e.g., depreciable property, inventory property, supplies under Regulations section 1.162-3, nondepreciable section 263(a) property, property deductible as a current expense, etc).

6 If the property is not currently treated as depreciable or amortizable property, attach a statement of the facts supporting the proposed change to depreciate or amortize the property.

7 If the property is currently treated and/or will be treated as depreciable or amortizable property, the following information for both the present (if applicable) and proposed methods:
   a The Code section under which the property is or will be depreciated or amortized (e.g., section 168(g)).
   b The applicable asset class from Rev Proc 87-56, 1987-2 CB 674, for each asset depreciated under section 168 (MACRS) or under section 1400L; the applicable asset class from Rev Proc 83-35, 1983-1 CB 745, for each asset depreciated under former section 168 (ACRS); an explanation why no asset class is identified for each asset for which an asset class has not been identified by the applicant.
   c The facts to support the asset class for the proposed method.
   d The depreciation or amortization method of the property, including the applicable Code section (e.g., 200% declining balance method under section 168(b)(1)).
   e The useful life, recovery period, or amortization period of the property.
   f The applicable convention of the property.
   g A statement of whether or not the additional first-year special depreciation allowance (for example, as provided by section 168(k), 168(l), 168(m), 168(n), 1400L(b), or 1400N(d)) was or will be claimed for the property. If not, also provide an explanation as to why no special depreciation allowance was or will be claimed.
Attachment 1
Form 3115, Part II, Line 12
Description of Item When Overall Method of Accounting Is Not Being Changed, or When Overall Method is Being Changed and Also Changing to a Special Method

Item being changed:
DCN 184: Repairs and maintenance under Treas. Regs. Section 1.162-4; capitalization (and depreciating if applicable) improvements to tangible property under Treas. Regs. Sections 1.263(a)-3; and the definition of unit of property.

DCN 186: Deduction of nonincidental materials and supplies when used and consumed under Treas. Regs. Section 1.162-3(a)(1), (c)(1).

DCN 187: Deduction of incidental materials and supplies when paid or incurred under Treas. Regs. Section 1.162-3(a)(2), (c)(1).

DCN 192: The capitalization of acquisition or production costs (and depreciating if applicable, such property under IRC Sections 167 or 168) under Treas. Regs. Section 1.263(a)-2.

Present method:
DCN 184: The taxpayer’s present method of accounting for repairs, capitalization (and depreciation if applicable) improvements to tangible property; and the definition of unit of property has been consistent with regulations in effect for years prior to 2014.

DCN 186: The taxpayer’s present method of accounting for deducting nonincidental materials and supplies has been consistent with regulations in effect for years prior to 2014.

DCN 187: The taxpayer’s present method of accounting for deducting incidental materials and supplies has been consistent with regulations in effect for years prior to 2014.

DCN 192: The taxpayer’s present method of accounting for the capitalization of acquisition and production costs, and depreciating if applicable such costs under IRC Sections 167 or 168 has been consistent with regulations in effect for years prior to 2014.

Proposed method:
DCN 184: Adoption of Treas. Regs. Section 1.162-4 regarding the definition and treatment of repairs; Treas. Regs. Sections 1.263(a)-3 regarding the capitalization (and depreciating if applicable) improvements to tangible property; and to the definition of unit of property as modified by TD 9636.

DCN 186: Adoption of Treas. Regs. Section 1.162-3(a)(1), (c)(1) regarding the definition and treatment of deducting nonincidental materials and supplies when used and consumed as modified by TD 9636.

DCN 187: Adoption of Treas. Regs. Section 1.162-3(a)(2), (c)(1) regarding the definition and treatment of deducting incidental materials and supplies when paid or incurred as modified by TD 9636.

DCN 192: Adoption of Treas. Regs. Section 1.263(a)-2 regarding the capitalization of acquisition or production costs, and depreciating if applicable, under IRC Sections 167 or 168 as modified by TD 9636.

Present overall
Attachment 1 (continued)
Form 3115, Part II, Line 12
Description of Item When Overall Method of Accounting Is Not Being Changed, or When Overall Method is Being Changed and Also Changing to a Special Method

accounting method: Cash

Attachment 2
Form 3115, Part II, Line 13
Description of Trade or Business

Fluffit Company operates a uniform and linen rental business. Fluffit has a plant that utilizes multiple pieces of equipment in an assembly line-like process to treat, launder, and prepare rental items for its customers.

Principal business activity code 812330 (Linen & Uniform Supply). Overall method of accounting is cash.

Attachment 3
Form 3115, Part IV, Line 25
Methodology Used to Determine the Section 481(a) Adjustment

DCN 184: $0 Modified section 481(a) adjustment to adopt repair regulations, capitalization of improvements, definition of unit of property.

DCN 186: $0 Modified section 481(a) adjustment to adopt regulations regarding deduction of nonincidental materials and supplies when used and consumed.

DCN 187: $0 Modified section 481(a) adjustment to adopt regulations regarding deduction of incidental materials and supplies when paid or incurred.

DCN 192: $0 Modified section 481(a) adjustment to adopt regulations for capitalization of acquisition or production costs, and depreciating if applicable, under IRS sections 167 or 168.