ARE WE DONE YET? WHAT’S NEXT WITH THE TANGIBLE PROPERTY REGULATIONS?

Feb. 9, 2016
## Agenda

<table>
<thead>
<tr>
<th>Topics</th>
<th>Minutes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Protecting Americans from Tax Hikes (PATH) Act of 2015</td>
<td>20</td>
</tr>
<tr>
<td>Tangible property update</td>
<td>15</td>
</tr>
<tr>
<td>- Maintaining compliance</td>
<td></td>
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<tr>
<td>- De minimis safe harbor–small taxpayers</td>
<td></td>
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<tr>
<td>- Dispositions</td>
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<tr>
<td>Retail safe harbor</td>
<td>30</td>
</tr>
<tr>
<td>Methods update and year-end planning</td>
<td>10</td>
</tr>
</tbody>
</table>
PROTECTING AMERICANS FROM TAX HIKES (PATH) ACT OF 2015
2015 PATH Act

- Enacted Dec. 18, 2015
- Retroactively extends 50+ expired tax provisions
- Act provides permanent, five-year or two-year extensions
- Mostly taxpayer-favorable
Permanent extensions

- Research and development tax credit
- Small business expensing—$500,000 section 179 limit
- 15-year recovery period for certain property
- Curb certain real estate investment trust (REIT) transactions
- Changes to related-party loss rules for ‘tax-indifferent’ parties
Five-year extensions—2019 and beyond

- Bonus depreciation (50 percent, 40 percent, 30 percent)
- Work Opportunity Tax Credit (40 percent of first $6,000)
- Solar investment credits (30 percent, 26 percent, 22 percent)
- Wind production and investment credits (phases out over five years)
- New markets tax credit ($3.5 billion of credit allocations each year)
- Look-through treatment for payments of dividends, interest, rents and royalties between related controlled foreign corporations
Two-year extensions through 2016

- Empowerment zones
- Energy tax extenders
  - Section 45 production tax credit
  - Section 179D deduction
  - Alternative fuel and fuel mixture tax credits
  - Biodiesel and renewable diesel credit
  - Section 30C alternative fuel vehicle refueling property credit
  - Section 45L new energy efficient homes credit
  - Credit for new qualified fuel cell motor vehicles
Research and development credit

• Retroactive to 2015
• Credit based on percentage of qualifying research expenses—wages, supplies, contract research
• Regular credit vs. alternative simplified credit
• Modifications starting after Dec. 31, 2015:
  − Eligible small businesses can claim credit against alternative minimum tax
  − Certain small start-up businesses can claim credit (up to $250,000) against payroll tax liabilities
# Extension of 15-year qualified property

<table>
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<tr>
<th></th>
<th><strong>Leasehold improvements</strong></th>
<th><strong>Retail improvements</strong></th>
<th><strong>Restaurant building and improvements</strong></th>
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<tr>
<td>Requirements:</td>
<td>• Pursuant to a lease</td>
<td>• Interior improvement</td>
<td>• Interior improvement</td>
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<tr>
<td></td>
<td>• Lease not between related parties</td>
<td>• Nonresidential real property</td>
<td>• Buildings PIS post-2008</td>
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<tr>
<td></td>
<td>• Interior improvement</td>
<td>• Open to general public</td>
<td>• New or acquired buildings</td>
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<tr>
<td></td>
<td>• Nonresidential real property</td>
<td>• Used in retail trade</td>
<td>• &gt; 50 percent of square footage devoted to prep of and seating for on-premises consumption of prepared meals</td>
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<td>• PIS (placed in service) &gt; three years after building PIS</td>
<td>• PIS &gt; three years after building PIS</td>
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<td>Does not apply to:</td>
<td>• HVAC units located outside</td>
<td>• Enlargement of building</td>
<td>• Buildings PIS pre-2009</td>
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<tr>
<td></td>
<td>• Enlargement of building</td>
<td>• Elevators and escalators</td>
<td>• Section 1245 personal property</td>
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<td></td>
<td>• Elevators and escalators</td>
<td>• Common area structural components</td>
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<td>• Common area structural components</td>
<td>• Internal structural framework</td>
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<td>• Section 1245 personal property</td>
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<tr>
<td></td>
<td>• Residential rental property</td>
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<tr>
<td>Bonus Depreciation:</td>
<td>Yes</td>
<td>No</td>
<td>Yes for pre-2009</td>
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<td>Recovery Period, Method, Convention:</td>
<td>• 15-year • Straight-line • Half-year or mid-quarter</td>
<td>• 15-year • Straight-line • Half-year or mid-quarter</td>
<td>No for post-2008</td>
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Bonus depreciation

- 2015 to 2017 = 50 percent of basis of qualifying property
- 2018 = 40 percent of basis of qualifying property
- 2019 = 30 percent of basis of qualifying property
- New “qualified improvement property” eligible for bonus depreciation after 2015
  - Interior improvements placed in service after building is placed in service (39-year property)
  - Does not include building enlargements, elevators or escalators or internal structural framework
Section 179D energy efficient commercial property

• Retroactively extended–2015 and 2016
• Immediate deduction energy efficient improvements:
  − Lighting
  − Heating, cooling, ventilation and hot water systems
  − Building envelope
• Deduction of up to $1.80 per square foot for each category in lieu of depreciating property
• Higher threshold to qualify for the deduction starting in 2016
Indian reservation property

• Nonresidential property
  – Used in active conduct of a trade or business within an Indian reservation
  – Not used or located outside an Indian reservation on a regular basis
  – Not acquired from a related person
  – Not used for certain gaming purposes

• Faster recovery periods for common types of property
  – Three-year property instead of five years
  – Four-year property instead of seven years
  – Nine-year property instead of 15 years
  – 22-year property instead of 39 years

• No AMT adjustment if shorter periods used
TANGIBLE PROPERTY UPDATE
The story continues…

- Continued confusion with the rules and required compliance
- Diversity of rules and practices between book and tax
- Lack of transparency into asset details
- Making changes in fixed asset systems after assets have been reviewed
- Maintaining methods and elections
- Managing risk with audit trail to adjustments
Annual elections

• Capitalize materials and supplies—section 1.162-3(d)
• De minimis safe harbor—section 1.263(a)-1(f)
• Capitalize employee compensation/overhead—section 1.263(a)-2(f)(iv)(B)
• Safe harbor for small taxpayers—section 1.263(a)-3(h)(1)
• Capitalize repair and maintenance costs—section 1.263(a)-3(n)(1)
• Partial disposition—section 1.168(i)-8(d)(2)
De minimis safe harbor update

Notice 2015-82

• Taxpayers without an applicable financial statement (AFS)
• Must have procedures in place at the beginning of the year
• Increase in de minimis amount from $500 to $2,500
• Effective for tax years beginning on or after Jan. 1, 2016
Disposition rules

• Annual election made in year disposition occurs
• May claim a loss upon the disposition of a structural component of a building
• Late election for 2014 via Form 3115 after new repairs are classified as capital improvement
• Simplified method for determining adjusted basis of disposition, including discounted replacement cost, replacement cost of partial disposition as a percentage of replacement cost and cost segregations
• Avoid pyramiding asset basis over years
Disposition loss denied

IRS field attorney advice 20154601F

- Taxpayer not entitled to a disposition loss estimated through a statistical sampling study
- Failed to establish assets were disposed when new assets were installed
- Utilized incorrect method to calculate disposition loss
- Taxpayer records did not fully substantiate the estimated disposition loss
RETAIL AND RESTAURANT INDUSTRY ISSUE RESOLUTION
Repairs safe harbor—retail/restaurant

Rev. Proc. 2015-56

- Simplified method of analyzing remodel and refresh costs, 75 percent safe harbor
- Requirements to use the safe harbor
- Procedures to elect the safe harbor
- Effective for tax years beginning on or after Jan. 1, 2014
Rev. Proc. 2015-56

Applies to:

A qualified taxpayer

Qualified costs

Remodel-refresh project

A qualified building
Qualified taxpayers must have an AFS

1. A financial statement required to be filed with the Securities and Exchange Commission (SEC) (the Form 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
   - Credit purposes;
   - Reporting to shareholders, partners, or similar persons; or
   - 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 IRS)
Rev. Proc. 2015-56—qualified taxpayer

• Is in the trade or business of selling merchandise to customers at a retail location, for which the taxpayer reports or conducts activities within NAICS codes 44 or 45;

• Is in the trade or business of preparing and selling meals, snacks or beverages to customer order for immediate on-premises and/or off-premises consumption for which the taxpayer reports or conducts activities within NAICS code 722; or

• Owns, or leases, a qualified building to a qualified taxpayer and incurs remodel-refresh costs
Rev. Proc. 2015-56—qualified taxpayer (cont.)

- Does not include taxpayers that primarily report or conduct activities within the following codes:
  - Code 4411 (automotive dealers)
  - Code 4412 (other motor vehicle dealers)
  - Code 447 (gas stations)
  - Code 45393 (manufactured home dealers) and
  - Code 454 (nonstore retailers)
Does not include taxpayers that primarily report or conduct activities within the following categories:

- Those taxpayers that are primarily in the trade or business of operating hotels and motels; civic or social organizations; or amusement parks, theaters, casinos, country clubs, or similar recreation facilities; and

- Those taxpayers that primarily report or conduct activities within code 7223 (special food services, i.e., food service contractors, caterers, and mobile food services)
Rev. Proc. 2015-56—qualified costs

- Amounts paid for remodel, refresh, repair, maintenance or similar activities performed on a qualified building as part of a remodel-refresh project
Examples

- Painting, polishing or finishing interior walls
- Adding, replacing, repairing, maintaining, or relocating permanent floor, ceiling or wall coverings, including millwork
- Adding, replacing, repairing, maintaining or relocating kitchen fixtures
- Adding, replacing or modifying signage or fixtures
- Relocating departments, eating areas, check-out areas, kitchen areas, beverage areas, management space, storage space or similar areas within the existing footprint of the qualified building
- Increasing or decreasing the square footage of departments, eating areas, check-out areas, kitchen areas, beverage areas, management space, storage space or similar areas within the existing footprint of the qualified building
Rev. Proc. 2015-56—qualified costs (cont.)

- Adding, relocating or removing a room or rooms (for example, dressing rooms, “private” dining space, front office space, or break rooms) within the existing footprint of the qualified building
- Moving, constructing or altering walls within the existing footprint of the qualified building
- Adding, relocating, removing, replacing or re-lamping lighting fixtures or adding reflectors, mirrors or other similar devices to existing lighting fixtures
- Repairing, maintaining, retrofitting, relocating, adding or replacing building systems defined in section 1.263(a)-3(e)(2)(ii)(B) within the existing footprint of the qualified building
- Making non-structural changes to exterior facades
Rev. Proc. 2015-56—qualified costs (cont.)

- Relocating, replacing or adding windows or doors (including replacing a manual door with an automatic door) within the existing footprint of the qualified building
- Repairing, maintaining or replacing the roof or portion of the roof within the existing footprint of the qualified building
- Replacing facade materials around windows and entrances
- Repair and maintenance to the qualified building that directly benefits or is incurred by reason of a remodel-refresh project
- Removal and demolition, other than demolition subject to section 280B, of structural components of a qualified building (for example, insulation, windows, drywall and similar property) that directly benefit or are incurred by reason of a remodel-refresh project
Rev. Proc. 2015-56—qualified costs (cont.)

• Obtaining permits or other similar authorizations that directly benefit or are incurred by reason of a remodel-refresh project

• Architectural, engineering and similar services that directly benefit or are incurred by reason of a remodel-refresh project
• Section 1245 property (personal property)
• An intangible, including the creation or maintenance of computer software
• Land, including nondepreciable land improvements, or depreciable land improvements (e.g., sidewalks, parking lots, depreciable landscaping)
• The initial acquisition, production or lease of a qualified building, including purchase price, construction costs, transaction costs and the costs of work performed prior to the date that the qualified building is initially placed in service by the qualified taxpayer
• The initial build-out of a leased qualified building, or a portion thereof, for a new lessee
• Activities to rebrand performed within two tax years following an acquisition or initial lease
• Activities performed to ameliorate a material condition or defect that existed prior to the qualified taxpayer's acquisition or lease of the qualified building
• Material additions to a qualified building, including the building systems. Solely for purposes of this safe harbor, additions mean enlarging, expanding or extending the square footage of the qualified building
• Expanding, or extending the building systems in conjunction with enlarging, expanding or extending the square footage of the qualified building
• Restoration caused by a casualty loss
• Adaption of more than 20 percent of the total square footage of a qualified building to a new or different use or uses
• Remodel-refresh costs incurred during a temporary closing
  - A temporary closing is a closing of the qualified building during normal business hours for more than 21 consecutive calendar days
• The cost of any property for which the qualified taxpayer has claimed a deduction under section 179, 179D or 190
A planned undertaking to alter the physical appearance and/or layout for one or more of the following purposes:

- To maintain a contemporary and attractive appearance
- To more efficiently locate retail or restaurant functions and products
- To conform to current retail or restaurant building standards and practices
- To standardize the consumer experience if a qualified taxpayer operates more than one qualified building
- To offer the most relevant and popular goods within the industry
- To address changes in demographics by changing product or service offerings and their presentations
Rev. Proc. 2015-56—qualified building

• Qualified building means each building unit of property used by a qualified taxpayer primarily for selling merchandise to customers at a retail location or primarily for preparing and selling food or beverages to customer order for immediate on-premises and/or off-premises consumption.

• In the case of a lease of an entire building, the building unit of property is the building and its structural components subject to the lease.

• In the case of a lease of a portion of a building (such as a store, a floor, or certain square footage) to a qualified taxpayer, the building unit of property is the portion of the building and the associated structural components subject to the lease.
For purposes of the remodel-refresh safe harbor method of accounting, remodel-refresh costs are not treated as paid or incurred (“paid”), and therefore are not taken into account, until the tax year when the capital expenditure portion under the safe harbor is placed in service.

However, if the qualified building is sold or otherwise disposed of before the capital expenditure portion is placed in service, the remodel-refresh costs are treated as paid in the tax year such building is sold or otherwise disposed of.
Rev. Proc. 2015-56–safe harbor

- The qualified taxpayer must treat 75 percent of its qualified costs paid during the tax year as deductible amounts and the remaining 25 percent of its qualified costs as costs for improvements.
Rev. Proc. 2015-56—documentation requirement

- A qualified taxpayer utilizing the remodel-refresh safe harbor must document its qualified costs in a manner substantially similar to the standard set forth in Appendix A to this revenue procedure.
Rev. Proc. 2015-56—limitations on partial dispositions

• A qualified taxpayer must not make the partial disposition election for any portion of an original qualified building or any portion of any improvement or addition to an original qualified building.

• A qualified taxpayer must revoke the partial disposition election by filing either:
  - An amended federal tax return for the tax year for which the partial disposition election was made and before the due date, including extensions, for the first tax year that uses the remodel-refresh safe harbor.
  - A Form 3115, Application for Change in Accounting Method, with the qualified taxpayer's timely filed original federal tax return for the qualified taxpayer's first or second tax year beginning after Dec. 31, 2013 (Sept. 15, 2016 for calendar-year taxpayers).
• If a qualified taxpayer does not make this revocation, the change in method of accounting to utilize the remodel-refresh safe harbor is made on a cut-off basis for the qualified building to which the unrevoked partial disposition election pertains.
Rev. Proc. 2015-56–general asset accounts

- A qualified taxpayer must make a general asset account election to include in a general asset account any asset that is Modified Accelerated Cost Recovery System (MACRS) property and that comprises a qualified building.

- Thus, a qualified taxpayer must include in general asset accounts:
  - The capital expenditure portion;
  - Existing qualified buildings that are MACRS property; and
  - Prior years' improvements that are MACRS property.
Rev. Proc. 2015-56–general asset accounts (cont.)

• If a qualified taxpayer is not eligible to use the remodel-refresh safe harbor for certain qualified costs, the qualified taxpayer is not required to include in general asset accounts:
  − The existing qualified building (including its structural components) to which those qualified costs pertain
  − Improvements made to that qualified building and placed in service prior to the first tax year that the qualified taxpayer uses the remodel-refresh safe harbor
<table>
<thead>
<tr>
<th>Example 6: Refresh</th>
<th>Example 7: Building refresh; limited improvement</th>
<th>Example 8: Major remodel</th>
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<tbody>
<tr>
<td>Consists of: Make cosmetic and layout changes to store interior; perform general repairs and maintenance to modernize building;</td>
<td>Assume same facts as example 6 plus:</td>
<td>Assume same facts as example 6 plus:</td>
</tr>
<tr>
<td>Replace and reconfigure display tables and racks, including moving walls, relocating lighting and repairing floors to accommodate redesign;</td>
<td>Increase building's footprint by constructing new loading dock and adding second overhead door; and</td>
<td>Replace exterior walls with windows; rebuild and remove walls, rebuild facades;</td>
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<tr>
<td>Relocate lighting; replace damaged ceiling tiles;</td>
<td>Upgrade electrical system to provide lighting and power to new space</td>
<td>Replace vinyl flooring with ceramic tile; replace ceiling tile with acoustical tile;</td>
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<tr>
<td>Repaint; patch holes in walls; replace damaged ceiling tiles;</td>
<td></td>
<td>Remodel bathrooms with higher quality material;</td>
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<td>Clean and repair wood flooring; and</td>
<td></td>
<td>Replace the escalators; add an elevator;</td>
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<tr>
<td>Power wash building exteriors</td>
<td></td>
<td>and</td>
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<tr>
<td>Refresh activities are not betterments</td>
<td>Cost related to example 6 (refresh) is not capitalized; cost associated with the addition is a betterment and capitalized in accordance with section 263(a)</td>
<td>The physical nature of the work and the effects of the building’s structure and system result in betterment of buildings structures and several of its systems</td>
</tr>
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METHODS UPDATE AND YEAR-END PLANNING
Updated Form 3115

• Released January 2016
• New form includes multiple revisions and updates, including:
  – Ability to list multiple method change numbers on a single Form 3115
  – Revised questions to take into account eligibility rules of Rev. Proc. 2015-13
  – A requirement to provide the legal basis for any proposed method of accounting change for both automatic and nonautomatic changes
Highlights from new Form 3115 instructions

- New requirement to provide a legal basis for only certain automatic changes
- Clarification for identifying filer
- New mailing address (Kentucky)
Common method changes

Decrease in taxable income
- Deferral method of accounting for advance payments
- Bad debts
- Incurred, but not reported
- Software developments costs
- Depreciation/amortization
- Inventory valuation—LCM and subnormal goods
- Self-developed UNICAP method
- Prepaids 12-month rule

Increase in taxable income
- Generally improper to proper method changes
- Specific item cash to accrual
- Accrued bonuses not fixed at year end
- Workers’ compensation liabilities
- LIFO termination
- Simplified UNICAP method
Common elections to consider

- Elect ADS on class-by-class basis
- Safe harbor for success-based fees
  - Rev. Proc. 2011-29
- Elect not to deduct eligible prepaid under 12-month rule
- Tangible property elections
  - De minimis safe harbor
  - Capitalize and depreciate rotable, temporary or standby emergency spare parts
  - Capitalize employee compensation and/or overhead
  - Capitalize repair costs
  - Partial disposition election
Contact RSM

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Related resources

To learn more about the tangible property regulations, please visit our resource center at: www.rsmus.com/what-we-do/services/tax/lead-tax/tangible-property-services.html
<table>
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<tr>
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<tr>
<td>8</td>
<td>9</td>
<td>10</td>
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<td>12</td>
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<tr>
<td>TODAY</td>
<td>Are we done yet? What's next with the tangible property regulations?</td>
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<td>IRS refunds—Does your company have one coming? 1-2 p.m. EST</td>
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THANK YOU FOR YOUR TIME AND ATTENTION