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## **Final Capitalization Regulations (TD 9636)**

### **Practical issues for Taxpayers**

For tax year 2014, the Final Capitalization regulations "TPR" present two major challenges to our clients and CPAs:

1. Taxpayers are required to comply with the final regulations for transactions during their first tax year beginning after 2013 and subsequent tax years.
2. IRS says taxpayers should apply for an automatic change in accounting method to bring **prior-year** transactions into compliance with the new regulations as of the first day of the first tax year.

Hence, for 2014 and future tax years, taxpayers are required to **expense or capitalize expenditures in accordance with the final regulations**. Failure to make a good faith effort to comply with the regulations could possibly subject the taxpayer to the **20% accuracy-related penalties** under §6662 and could subject tax advisers to the §6694 preparer penalties.

### **Adjustments For Tax Years Beginning Before 2014 (Section 481 Adjustments).**

The change to conform to these final regulations will generally be a ***change in method of accounting*** under §446(e) and as such require taxpayers to apply the TPR to the first tax year beginning 2014 and **filing of IRS form 3115**.

Moreover, IRS requires the taxpayer complying with these final regulations to take into account an ***adjustment under §481(a)***. This means that for expenditures relating to **assets still on hand at the beginning of the 2014 tax year**, the IRS expects taxpayers to calculate the cumulative effect on taxable income resulting from **retroactively** complying with the final regulations. Taxpayers should determine the resulting §481(a) adjustment and file a properly **completed Form 3115** with their 2014 tax return by the due date of the return, including extensions.

**Naturally, compliance with these new and very complex regulations requires additional time on our part and added costs to the client.** To allow you the opportunity to minimize the cost of your compliance with the new TPR, we have enclosed a form for your review and completion prior to preparation of your taxes. Please visit our website at [www.buterbaughcpa.com](http://www.buterbaughcpa.com) under the section "**Businesses – New Tax Developments**" to learn more about the impact of the TPR.

### **Examples of §481(a) adjustments (partial List only)**

- 1- **Partial disposition of assets** - (i.e. you replaced all or portion of your rental property roof, HVAC, etc. in 2010). You will get a favorable §481(a) adjustment for expensing the adjusted basis of the disposed portion of the property. This adjustment will reduce your taxable income in 2014.

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- 2- Improper method of accounting used for several years for certain items** - (i.e. you expensed purchases of tangible property valued over \$500 instead of capitalizing them. You will have an unfavorable §481(a) adjustment. The adjustments will be netted (favorable vs. non-favorable). If the net was favorable to taxpayer, it will be deducted from taxable income in 2014. However, if unfavorable, taxpayer can spread the adjustment (income) over four (4) years with no interest or penalty assessed.
- 3- Small taxpayer safe harbor election** – (i.e. You capitalized certain repairs less than \$10,000 in 2009 to a rental building you own and have \$7,000 in adjusted basis remaining as of 12/31/2013) If you qualify as a small taxpayer, you can deduct up to \$10,000 or 2% of the value of the building's original cost instead of capitalizing the expenditure. In this instance you can expense an additional \$7,000 in 2014.
- 4- De minimis safe harbor election** – (i.e. in 2012 you purchased eight desks for \$400 each totaling \$3,200. You capitalized them and have depreciated it for 2 years, with 5 years of life remaining.) Per final regulations if you have a written capitalization policy, you can expense items purchased costing less than \$500. So you can take a deduction for the remaining basis i.e. approx. 54% remaining value - \$1,728 in 2014. This of course is a taxpayer favorable adjustment.)

Above examples are not exhaustive. In order to determine the §481(a) adjustment accurately, requires reviewing the taxpayer's balance sheet and fixed asset schedule (depreciation schedules) in detail and cooperation of taxpayer in providing all necessary source documents. Moreover, instances where taxpayer has improperly expensed items instead of capitalizing them in previous years can only be identified by the taxpayer short of an audit. Therefore, we as preparers will not be responsible for any errors in calculating the adjustment amount.

As evident from above examples, completing form 3115 and calculating the §481(a) adjustment separately for each entity or business activity of a taxpayer is an involved and time consuming proposition and the results are only as valid as the accuracy and completeness of the information available to preparers and source documents and information provided by taxpayer.

We are cognizant of the cost vs. benefit aspect of the compliance, however the decision as to how far back and how detailed of a review to make, is one that the taxpayer must make and consent to. Accordingly, on page 3 you will find a consent and authorization form for you to sign prior to us rendering these services. Please review the three levels of service available and make the selection most suitable to your situation. We require your signature, name and date at the bottom of the form.

David L Buterbaugh, P.C.

**REQUIRED for 2014**

**Consent and Authorization**

**Preparation of Form 3115 and Determination of Sec 481(a) Adjustment**

**Please select one of the following:**

Minimal Preparation Cost

I (We) are aware of the regulations and requirements. **No** Sec 481(a) adjustment is required. Please file form 3115 showing compliance with the new regulations effective beginning of 2014 and zero Section 481(a) prior period cumulative adjustment. I (We) understand that this will require some additional time on your part and agree to be responsible for the **added cost** involved in this compliance issue.

Moderate Preparation Cost

I (We) are aware of the regulations and requirements. We have previously adopted and have a written capitalization policy. A Sec 481(a) adjustment **is required**. I (We) have calculated the Sec 481(a) adjustment amount and will furnish it to you. Please file form 3115 showing compliance with the new regulations effective beginning of 2014 and the Section 481(a) prior period cumulative adjustment amount that will be provided to you. We understand that this will require additional time on your part and agree to be responsible for the **added cost** involved in this compliance issue.

Higher Preparation Cost

I (We) are **not** familiar with the regulations and requirements. We do not know if any Sec 481(a) adjustment is required. Please review our fixed asset schedule to determine if any prior period cumulative adjustment is required and prepare the Form 3115 accordingly. We will provide the necessary information and documentation you require in a timely manner. We understand that this will require additional time on your part and agree to be responsible for the **added cost** involved in this compliance issue.

By signing below, I (We) acknowledge that we have previously adopted a written capitalization policy, and I (We) are solely responsible for the accuracy and completeness of this information provided to the preparer for preparation of Form 3115. As such, the preparer can rely on this information in preparation of the Form 3115. I (We) individually and collectively shall hold harmless and indemnify the preparer from any all claims including but not limited to additional compliance costs, lost refunds, taxes, penalties, and interest that may be incurred.

Signature: \_\_\_\_\_

Date: \_\_\_\_\_

Name & Title: \_\_\_\_\_