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Issue Contents

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At Last – Relief From the Repair Regulations

-by Neil E. Harl*

The long-running saga involving the IRS effort to retake the high ground[1] in drawing the line between what is a repair and what must be capitalized[2] took an abrupt turn on February 13, 2015, when IRS issued *Revenue Procedure 2015-20* which lifted the burden of filing Forms 3115 for most small taxpayers.[3] That was welcome news to many practitioners (and taxpayers).

History of the controversy

After losing two litigated cases early in this century,[4] the Internal Revenue Service embarked upon a major project to recover the long-held position of being the arbiter of what was a "repair" and thus income tax deductible and what expenditures had to be capitalized.[5] After several failed attempts to achieve that objective,[6] the Department of the Treasury issued final "repair" regulations on September 13, 2013[7] with an effective date of January 1, 2014.[8]

The Preamble to the final regulations[9] mentioned a "safe harbor" for "small taxpayers" in recognition of the complexity and far-reaching effects of the regulatory provisions but did not provide any details of what that "safe harbor" might entail. *Revenue Procedure 2014-16*[10] defined "qualified taxpayer" as a taxpayer whose average annual gross receipts, as determined under the regulations,[11] for the three preceding taxable years is [sic] less than or equal to $10,000,000. The key issue, of course, was what a "qualified taxpayer" was expected to do. That authority merely provided a list of which parts of Form 3115 were required to be completed by a "qualified taxpayer."[12] At that stage, it was clear that the only dispensation accorded "qualified taxpayers" was to be allowed to skip some parts of Form 3115.[13] That development triggered strong resistance among small taxpayers, some of whom had been told by their tax advisors (and some commentators) that small taxpayers could forget about filing Form 3115 altogether.

The "blockbuster" news

Under considerable public pressure (and, apparently, pressure from Congress), the Internal Revenue Service on February 13, 2015, announced that they were making ". . . it easier for small business owners to comply with the final tangible property regulations."[14] The announcement unveiled a "simplified procedure" which allows small businesses to change a method of accounting under the final tangible property regulations on a prospective basis for the first taxable year beginning on or after January 1, 2014. Moreover, the announcement waives the requirement for small business taxpayers to complete and file a Form 3115 under the simplified procedure.[15] The taxpayer is permitted to make the desired changes on its federal tax return without including a separate Form 3115 or separate statement for its

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its trades or businesses.

The new simplified procedure, explained in detail in *Revenue Procedure 2015-20*[16] is available to small businesses, including sole proprietors, with assets totaling less than $10 million in total assets as of the first day of the taxable year for which a change of accounting under the final tangible property regulations and corresponding procedures is effective or average annual gross receipts of $10 million or less for the prior 10-years. Eligible taxpayers under those limits are allowed to make tangible property changes in methods of accounting for amounts paid or incurred (and dispositions) in taxable years beginning on or after January 1, 2014.[17] In a puzzling passage, the Revenue Procedure[18] states "In addition, for their first taxable year that begins on or after January 1, 2014, small business taxpayers are permitted to make certain tangible property changes without filing a Form 3115.[19] The Revenue Procedure, elsewhere in the document, do not limit the right to avoid filing Forms 3115 beyond the "first taxable year that begins on or after January 1, 2014."[20] The guidance appears to continue the Form 3115 filing requirement for automatic changes in method of accounting, apparently including Commodity Credit Corporation (CCC) loans.[21]

For taxpayers who had already filed their federal tax return for 2014, they may withdraw the Form 3115 by filing an amended federal tax return on or before the due date of the taxpayer's federal tax return beginning on or after January 1, 2014, including extensions.

One exception to the provision about the change in requirements to file Form 3115 is that a shift from accrual to cash accounting is not within that exception. Under Sections 14.03 and 14.13 of Rev. Proc. 2015-20,[22] for such a change in method of accounting (accrual to cash), the taxpayer is required to file a Form 3115 and compute an I.R.C. Sec. 481 adjustment (except for changing from the "crop" method of accounting) which requires the taxpayer to take into account "... those adjustments which are determined to be necessary solely by reason of the change in order to prevent amounts from being duplicated or omitted. . . ."

Request for comment on *de minimis* safe harbor limit

Revenue Procedure 2015-20[23] also requests comments by April 21, 2015, on whether the $500 safe-harbor threshold for items written off as an ordinary and necessary business expense is appropriate.[24] As explained in the *Revenue Procedure,*[25] the safe harbor "merely establishes a minimum threshold below which qualified amounts are considered deductible."

ENDNOTES

1 See Ingram Industries, Inc & Subs. v. Comm'r, T.C. Memo. 2000-323 (overhaul of towboat diesel engines, out of action for 10-12 days, held to be repairs); FedEx Corp. v. United States, 291 F. Supp. 2d 699 (W.D. Tenn. 2003), *aff'd,* 2005-1 U.S. Tax Cas. (CCH) ¶ 50,186 (6th Cir. 2005) (jet airplane maintenance operations held to be repairs).

2 See Treas. Reg. § 1.162-4. See IRPO ¶ 202,495, "Capitalization v. Repairs Audit Technique Guide."

3 See Rev. Proc. 2015-20, 2015-1 C.B. __.

4 See note 1, *supra*.

5 See note 2 *supra*.

6 See Prop. Treas. Reg. §§ 1.263-0, -1, -2, -3, Aug. 21, 2006; Proposed Treas. Reg. 12838-01, March 10, 2008; T.D. 9564, Dec. 23, 2011.

7 T.D. 9636, 0213-2 C.B. 331, *corrected* July 18, 2014.

8 Ann. 2013-7, 2013-2 C.B. 308.

9 T.D. 9636, Sept. 13, 2013, 2013-2 C.B. 331.

10 § 3.01(4)(1)(c)(ii), 2014-1 C.B. 606.

11 Treas. Reg. § 1.263(a)-3(h)(3).

12 See Harl, "What is a "Qualifying Taxpayer under the Repair Regulations?" 26 *Agric. L. Dig.* 9 (2015).

13 *Id.*

14 IR 2015-29.

15 *Id.*

16 2015-1 C.B. __.

17 Rev. Proc. 2015-20, 2015-1 C.B. __.

18 Rev. Proc. 2015-20, 2015-1 C.B. __.

19 Rev. Proc. 2015-20, 2015-1 C.B. __.

20 E.g., Rev. Proc. 2015-20, § 2.05, 2015-1 C.B. __.

21 See I.R.C. § 77. On February 2, 2015, IRS announced a modification of the transition rule in *Rev. Proc. 2015-13, 2015-1 C.B. 419*, allowing Form 3115 filings on or after January 16, 2015 through May 31, 2015, to be filed under Rev. Proc. 2011-14, 2011-1 C.B. 330 or under Rev. Proc. 2015-13, 2015-1 C.B. 419.

22 2015-1 C.B. __.

23 2015-1 C.B. __.

24 Treas. Reg. § 1.263(a)-1(f)(3)(iv). The address for comments is Internal Revenue Service, ATTN: CC:PA:LPD:PR, (Rev. Proc. 2015-20), Room 5203, P.O. Box 7604, Ben Franklin Station, Washington, D.C, 20044.

25 Rev. Proc. 2015-20, 2015-1 C.B. __.

CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr

ANIMALS

HORSES. The plaintiffs' daughter died while competing in a horse riding cross-country event. The plaintiffs filed a suit for wrongful death and negligent infliction of emotional distress against the trainer, alleging that the horse provided by the trainer was unfit to ride because of prior falls and lack of practice. The defendant trainer argued that a release of liability signed by one of the plaintiffs and the daughter prohibited the suit. The trial court granted the trainer an entry of judgment in the trainer's favor and the plaintiffs appealed, arguing that the release was unenforceable for ambiguity and did not cover the negligence of the trainer. On appeal, the appellate court affirmed. The release covered all liability except "direct, willful and wanton negligence." The plaintiffs argued that the release was ambiguous because it referred to the defendant as a trainer and not as a coach. The plaintiffs argued that a trainer refers to someone who trains horses and a coach is someone who coaches riders. Thus,