Final Tangible Property Regulations Increase De Minimis Threshold and Provide Retail Safe Harbor

By J.D. Lewis

As we approach year-end many taxpayers are likely considering year-end tax planning strategies. A critical step in this process is gaining an understanding of any new guidance or tax law changes which could impact your business. In recent weeks, guidance on the Final Tangible Property Regulations has been released that may be beneficial for many companies, some specifically beneficial to retailers and restaurant groups. The guidance includes changes to the De Minimis safe harbor limit for taxpayers without an applicable financial statement as well as a new safe harbor for taxpayers in the retail and restaurant industries.

Proactive tax planning today could be requisite to a taxpayer’s ability to utilize either of these safe harbors moving forward. Immediate action steps could include the revocation of a partial disposition election, making one or more late General Asset Account (GAA) elections, or establishing an applicable financial statement* (AFS).

IRS Raises De Minimis Safe Harbor Limit

The De Minimis safe harbor included within the final tangible property regulations affords taxpayers the opportunity to currently deduct the costs of acquiring items of tangible property that would otherwise require capitalization as long as such treatment is consistent with the taxpayer’s books and records. Previously the safe harbor was limited to property with an acquisition cost below $5,000 per invoice or per item as substantiated by an invoice for taxpayers with an AFS. Those taxpayers without an applicable financial statement were previously limited to a lower $500 de minimis threshold. Based on a multitude of comments received from tax practitioners and industry groups such as the AICPA; the IRS has decided to reduce the disparity between taxpayers with an AFS and those without an AFS. Effective for tax years beginning on or after January 1, 2016, the de minimis limit for taxpayers without an applicable financial statement will be increased to $2,500 per invoice or per item as substantiated by an invoice. This marks a substantial increase over the previous $500 limitation and more closely aligns with the original legislative intent of the regulations.

In order to take advantage of this taxpayer-favorable election for the 2016 tax year, a taxpayer must have capitalization procedures in place prior to the beginning of the 2016 tax year that expense amounts below a certain dollar amount for nontax purposes. This means calendar year taxpayers who want to utilize the de minimis safe harbor for the 2016 tax year must have capitalization procedures in place before 1/1/16. It should be noted that taxpayers electing the lower $2,500 safe harbor do NOT need to have a written capitalization policy in place. With regards to tax years beginning before January 1, 2016, the IRS will not raise the issue of whether a taxpayer without an AFS can utilize the de minimis safe harbor for an amount that does not exceed the new $2,500 limit if the taxpayer otherwise satisfies...
the requirements for using the safe harbor. Taxpayers should examine their current capitalization procedures and take action as necessary.


**Safe Harbor for Retail and Restaurant Industries**

Remodel-refresh expenditures constitute a significant cost of doing business in the retail and restaurant industries. Many retailers own or operate multiple locations and refresh them at regular intervals. Recognizing this, the IRS and Treasury recently released favorable guidance to help qualifying taxpayers in the retail and restaurant industries more easily comply with the Final Tangible Property Regulations. The benefits of this legislation are two-fold: Helping to ease the compliance burden imposed upon certain qualified taxpayers while at the same time reducing the number of disputes with the IRS.

**Safe Harbor Overview**

Rev. Proc 2015-56 provides qualified retail and restaurant businesses with a safe-harbor method for determining whether costs paid or incurred to remodel or refresh a qualified building are currently deductible or require capitalization. Rev. Proc 2015-56 allows restaurant and retail businesses to capitalize and depreciate 25 percent of the qualifying remodel-refresh costs and deduct the remaining 75 percent of the remodel-refresh basis in the year incurred. The safe harbor may only be utilized by taxpayers with an AFS as defined for purposes of the *de minimis* safe harbor in the previously released Final Tangible Property Regulations. Rev. Proc. 2015-56 is effective for tax years beginning on or after January 1, 2014. A qualified taxpayer must file an accounting method change to use the safe harbor for the first time. Specific costs excluded from the safe harbor include but are not limited to section 1245 property, intangibles, land, initial acquisition or remodel costs, costs to ameliorate a material condition or defect existing prior to the qualified taxpayer’s acquisition or lease of the qualified building, material additions to the building or building systems, costs incurred during a temporary closing and restorations caused by damages to the qualified building for which the taxpayer is required to take a basis adjustment as a result of a casualty loss.

**General Asset Account**

In order to take advantage of the favorable guidance, qualified building property must be held in a MACRS General Asset Account. Any remodel-refresh costs capitalized under the safe harbor must be placed in a separate GAA. Taxpayers wishing to utilize the safe harbor are permitted to make a late GAA election through an automatic accounting method change.

**Partial Dispositions**

Taxpayers electing to apply the safe harbor may not make a partial disposition election to claim a loss on a retired structural component of the building. A taxpayer who has previously filed a timely or late
partial disposition election may revoke the election by filing an accounting method change and recognizing the previously claimed loss in income. An accounting method change to revoke a timely or late partial disposition election must be filed for a taxpayer’s first or second tax year beginning after December 31, 2013. If a revocation is not made the safe harbor will apply on a cut off basis and cannot be applied to previous tax years.

**New or Different Use**

The safe harbor will apply to costs incurred to convert a portion of the facility to a new or different use as long as no more than 20 percent of the total square footage of the building is converted to a new or different use. If more than 20 percent of the square footage is converted to a new or different use the safe harbor will not apply and all costs must be capitalized.

**Next Steps**

Qualifying taxpayers now have a viable option to more easily comply with the final tangible property regulations. Although the new guidance has been met with much initial fanfare from the tax community, there could be certain inherent drawbacks to implementing the safe harbor approach. The benefits and potential pitfalls of this legislation should be carefully evaluated. Proactive tax planning today could be requisite to a taxpayer’s ability to utilize these safe harbors moving forward. Immediate action steps could include the revocation of a partial disposition election, making one or more late GAA elections, or establishing an AFS.

If you believe your business may be impacted or you’d like additional information on either of the safe harbors discussed above, please consult your Elliott Davis Decosimo tax advisor or J.D. Lewis at jd.lewis@elliottdavis.com.

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*In general, an AFS is a certified audited financial statement, a statement required to be filed with the Securities and Exchange Commission, a financial statement required to be filed with the federal or a state government.*

**Qualified taxpayers should be in the trade or business of selling merchandise to customers at retail, 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. Owns, or leases, a qualified building that is leased, or sublet, to a taxpayer that meets the specified activity requirements and incurs remodel-refresh costs.**

***Specifically excluded are automotive dealers, gas stations; manufactured home dealers; and non-store retailers; as well as those taxpayers that are primarily in the trade or business of operating hotels and motels; civic or social organizations; amusement parks, theaters, casinos, country clubs, or similar
recreation facilities; food service contractors, caterers, and mobile food services.

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