



October 8, 2014

Mr. Andrew Keyso, Jr.
Associate Chief Counsel
Income Tax & Accounting
Internal Revenue Service
1111 Constitution Avenue, N.W.
Washington, DC 20224

Re: \$500 De Minimis Safe Harbor Threshold and Retrospective Application of Final Tangible Property Regulations ([T.D. 9636](#)) for Small Businesses

Dear Mr. Keyso:

The American Institute of Certified Public Accountants (AICPA) appreciates the opportunity to submit comments with respect to the final regulations on the acquisition and improvement of tangible property (T.D. 9636) (hereinafter “Repair Regulations”). We also commend the Internal Revenue Service (IRS) and Department of the Treasury (“Treasury”) for taking into consideration the extensive amount of input received from stakeholders when issuing this guidance. However, we are deeply concerned about the administrative burdens on small businesses that continue to exist.

As we and our members have discussed with you on multiple occasions, we are particularly concerned about the administrative impact of the low amount (\$500) of the *de minimis* safe harbor threshold for taxpayers without an applicable financial statement¹ (AFS), the retrospective application of the rules, and the related administrative burdens on small businesses. We are also aware of Circular No. 230 obligations and challenges that practitioners will face when small businesses are unwilling or unable to precisely comply with this complex set of rules.

Accordingly, we respectfully request that the IRS and Treasury immediately modify the Repair Regulations to address these issues with our suggestions below. **Please note that time is of the essence as a significant portion of the burdens placed on small businesses (and their tax practitioners) from the transitional requirement of the Repair Regulations will occur between now and the upcoming filing season.**

¹ An applicable financial statement is a financial statement that is (i) a financial statement required to be filed with the Securities and Exchange Commission (SEC) (the 10-K or the Annual Statement to Shareholders); (ii) 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 (iii) 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).

Recommendations

To significantly reduce the unnecessary compliance burdens placed on small businesses under the Repair Regulations, the AICPA recommends modifying the guidance as follows:

- I. Increase the *de minimis* safe harbor threshold amount for taxpayers without an AFS from \$500 to \$2,500. We also recommend adjusting the *de minimis* safe harbor threshold amount on an annual basis for inflation.
- II. Allow small businesses² to elect to apply the Repair Regulations *prospectively*, without calculating adjustments with respect to prior-year tangible property costs. Specifically, we recommend providing small businesses with the following two options:
 - a. Adopt prospective application of the rules without computing a Section³ 481(a) Adjustment or filing a Form 3115, Application for Change in Accounting Method; or,
 - b. Adopt prospective application of the rules without computing a Section 481(a) Adjustment, but with filing a Form 3115 (“cut-off basis” with audit protection).

Background

Treasury Reg. § 1.263(a)-1(f) provides a *de minimis* safe harbor election for taxpayers. The *de minimis* safe harbor election provides two threshold amounts: \$500 for taxpayers without an AFS and \$5,000 for taxpayers with an AFS. Adjusting these threshold amounts in future tax periods for inflation is not currently provided for in the Repair Regulations; however, the IRS and Treasury retain the authority to change these threshold amounts through published guidance.⁴

A taxpayer electing to apply the *de minimis* safe harbor generally is permitted to deduct amounts paid to acquire, produce, or improve tangible property for tax purposes provided certain requirements are met. Taxpayers with an AFS must have written capitalization procedures in place as of the beginning of the applicable tax year that provide for expensing amounts paid for property costing less than a specified dollar amount, or property with a useful life of 12 months or less. The taxpayer must expense the property in its AFS in accordance with such procedures. The deduction covered by the safe harbor election is limited to \$5,000 per invoice (or per item, if substantiated on the invoice).

² For purposes of this letter, we have assumed that a small business taxpayer is a taxpayer with average annual gross receipts of \$10 million or less for the prior three taxable years, under rules similar to those applicable under sections 263A(b)(2)(B) and 460(e)(1)(B)(ii).

³ All references to “section” or “§” are to the Internal Revenue Code of 1986, as amended.

⁴ See page 18, [T.D. 9636](#).

A taxpayer without an AFS must have accounting procedures in place as of the beginning of the tax year for expensing amounts paid for property costing less than a specified dollar amount, or property with a useful life of 12 months or less. The taxpayer must expense the property in its books and records according to such procedures. The deduction covered by the safe harbor election is limited to \$500 per invoice (or per item, if substantiated on the invoice).

The *de minimis* safe harbor election does not preclude a taxpayer from deducting amounts in excess of the applicable threshold amount, however the taxpayer has the burden of establishing that expensing such excess amount clearly reflects income.⁵

Although the Repair Regulations provide several elections, such as the *de minimis* safe harbor election, many of the provisions require taxpayers to effectuate any required accounting method with a section 481(a) adjustment. Thus, taxpayers must review past expenditures related to tangible property (e.g., repairs, maintenance, and improvements), including fixed asset schedules and expense accounts. This review generally extends five or more years, depending on the type of asset. Taxpayers will also generally be required to file at least one Form 3115 including computation of section 481(a) adjustments. The IRS has acknowledged in recent meetings that it expects almost all businesses to file at least one Form 3115. These procedures required to comply with the Repair Regulations will create undue burdens for small business taxpayers.

Safe Harbor Threshold

The AICPA understands that the intent of the \$500 *de minimis* safe harbor election is to reduce the administrative burden of applying the complex set of capitalization rules for business taxpayers without an AFS (e.g., small business taxpayers). However, we are concerned that the \$500 threshold is too low to effectively achieve this underlying objective. We strongly recommend increasing the threshold for taxpayers without an AFS from \$500 to \$2,500.

To deduct amounts in excess of the \$500 threshold, small businesses must prove that expensing such amounts “clearly reflects income.” The clear reflection of income test can be subjective and difficult to apply for any taxpayer, especially for small businesses. The test is based on the taxpayer’s facts, circumstances, and interpretations of those facts and circumstances by the taxpayer and IRS. Thus, it is arbitrary and extremely difficult to apply, especially when the IRS believes that the clear reflection of income test is not satisfied. As a result, many disputes between taxpayers and the IRS end up in courts with the burden of proof solely on the taxpayer. Large businesses (e.g., taxpayers with an AFS), however, are allowed the higher (\$5,000) threshold. Thus, subjecting small businesses to the clear reflection of income test at such a low amount adds burdens to small businesses that do not exist for large businesses.

We also believe the \$500 threshold does not accurately reflect the current capitalization policy threshold for many small businesses. An informal survey of our members suggests that many of

⁵ See page 18, [T.D. 9636](#).

them and/or their small business clients already have a minimum capitalization threshold in excess of \$500. This finding indicates that the \$500 threshold would not provide the intended relief for many small businesses since taxpayers with a *de minimis* policy in excess of \$500 will have to deviate from historical as well as current treatment of many otherwise *de minimis* costs. In other words, small businesses would revise the current accounting procedures or implement new accounting policies to comply with the *de minimis* safe harbor rules. Therefore, we believe an increase in the threshold amount for taxpayers without an AFS is warranted to achieve the goal of the *de minimis* safe harbor election for such taxpayers.

Prospective Application of Repair Regulations

The AICPA commends the IRS for providing a number of small business taxpayer relief provisions in the Repair Regulations and procedural guidance (e.g., small taxpayer safe harbors and special accounting method change rules for completing Form 3115). To provide additional relief for small businesses, we suggest the IRS and Treasury consider permitting such businesses to elect to apply the provisions prospectively.

Because of the comprehensive changes made by the Repair Regulations, the IRS currently requires most businesses to file at least one Form 3115 to comply with the Repair Regulations. As noted above, the preparation and filing of these forms often require a detailed review of all prior expenditures related to tangible property (e.g., repair and maintenance deductions and capitalized amounts). In other words, small businesses must expend significant resources to update and maintain their old books and records to comply with the Repair Regulations, in addition to establishing new procedures and policies for 2014 and future years. Furthermore, because these taxpayers do not generally maintain relevant information (e.g., invoices) beyond the statute of limitations, gathering the information necessary to review and analyze treatment in years beyond the immediately preceding years would impose extreme difficulty.

In addition, the requirement to file accounting method changes with section 481(a) adjustments would impose an undue financial burden on small businesses. An informal survey of and comments from our members suggest that the cost of the retrospective application (i.e., preparation of Forms 3115 and computation of section 481(a) adjustments) for several taxpayers would easily exceed the cost of their annual tax return compliance. We believe that eliminating a review of past expenditures would significantly reduce the compliance cost for these taxpayers.

We note that Rev. Proc. 2014-16 allows many taxpayers to combine multiple method changes on one Form 3115. While this revenue procedure is a welcome simplification, the retrospective application (through the section 481(a) adjustment) adds both administrative and financial burdens for small businesses.

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Circular No. 230 Concerns

According to [Circular No. 230](#), Regulations Governing Practice before the IRS (“Circular 230”), a practitioner (e.g., certified public accountants, enrolled agents, attorneys, and others) may not willfully, recklessly, or through gross incompetence sign tax returns.⁶ Thus, a practitioner who prepares returns for clients that have not implemented the Repair Regulations (e.g., filing Form 3115 or including certain election statements) may not willingly sign tax returns. Furthermore, failure to comply with Circular 230 could subject these tax practitioners to censure, suspension, or disbarment of practice before the IRS.⁷

The AICPA and our members are concerned that the burdens placed upon small businesses noted above may discourage these taxpayers from complying with the Repair Regulations. Although, tax practitioners are subject to censure, they cannot force their clients to spend significant business resources to compute section 481(a) adjustments and file Forms 3115.

Conclusion

The AICPA urges the IRS and Treasury to immediately address the concerns of small businesses and their tax practitioners. Although small businesses will continue to face challenges when complying with the Repair Regulations, the recommended changes would have a substantial impact on these taxpayers by easing unnecessary compliance burdens. Specifically, increasing the \$500 de *minimis* safe harbor threshold to \$2,500 (plus inflation adjustments) would offer additional relief to small business taxpayers related to the implementation of the Repair Regulations. In addition, permitting small businesses to comply prospectively, with the option of filing Form 3115, would result in reduced administrative burdens and compliance costs for small businesses. **However, it is important to note, action is needed now in order to provide any substantial relief.**

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The AICPA is the world’s largest member association representing the accounting profession, with more than 400,000 members in 128 countries and a 125-year heritage of serving the public interest. Our members advise clients on Federal, state and international tax matters and prepare income and other tax returns for millions of Americans. Our members provide services to individuals, not-for-profit organizations, small and medium-sized businesses, as well as America’s largest businesses.

⁶ See §10.34 of [Circular No. 230](#).

⁷ See §10.38 of [Circular No. 230](#).

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We appreciate your consideration of our recommendations. If you have any questions, please contact me at (304) 522-2553 or jporter@portercpa.com; or you may contact Carol Conjura, Chair, AICPA Tax Methods and Periods Technical Resource Panel, at (202) 533-3040, or cconjura@kpmg.com; or Jason Cha, Technical Manager, at (202) 434-9231, or jcha@aicpa.org.

Sincerely,

A handwritten signature in black ink, appearing to read "Jeffrey A. Porter", enclosed in a thin black rectangular border.

Jeffrey A. Porter, CPA
Chair, Tax Executive Committee

cc: Scott Dinwiddie, Special Counsel to the Associate Chief Counsel (Income Tax & Accounting), Internal Revenue Service
Alexa Claybon, Attorney-Advisor, Office of Tax Legislative Counsel, Department of the Treasury
Ken Beck, Taxation Specialist, Office of Tax Legislative Counsel, Department of the Treasury
Merrill Feldstein, Senior Counsel (Income Tax and Accounting), Internal Revenue Service