

## **PROCEDURES FOR CORRECTING DEPRECIATION FOR TANGIBLE PERSONAL PROPERTY TAX REGS**

1. Provide client with the engagement letter addendum
2. Provide client with a copy of the Depreciation Report. Ask them to identify disposals or acquisitions.
3. For the qualified Small Taxpayer electing not to file Form 3115, perform steps 4 through 8 for acquisitions from 1/1/2014 forward. The following conditions are a valid reason NOT to file Form 3115:
  - a. Would not benefit from scrubbing prior assets; all prior assets are fully depreciated, and
  - b. Would not benefit from a late partial disposition, or
  - c. Would be able to generate expenses from one or both of the above, but doesn't want to because they can't currently use the losses (NOL, PAL, etc.)
4. Review the assets and code as appropriate (adjustment type).
  - a. UOP: Unit of property (#)
  - b. MS: Materials and supplies are tangible property used or consumed in the taxpayer's business (non-inventory). Review items purchased from 1/1/2014 forward unless desirable to go back.
  - c. RE: Repairs
  - d. CA: Capital asset – depreciable asset; verify correct life and method
5. Identify the Unit of Property (UOP) for all assets without regard to whether it should be capitalized or expensed. Make sure land is not included.

### **MATERIALS AND SUPPLIES**

6. Identify assets that qualify as Materials and Supplies. Use code MSE. Tangible property used or consumed in the business operations that is not inventory and that falls within any of the following categories qualifies and can be expensed:
  - a. Tools (used to maintain a UOP; not acquired as part of any single UOP)
  - b. Consumables (fuel, lubricants, water ; consumed in < 12 months
  - c. Less than 1 year economic useful life
  - d. \$200 or less
  - e. De minimis (written policy) of \$500 or less
  - f. IRS guidance
7. For the remaining materials and supplies, review and categorize as follows:
  - a. MSI – Incidental materials and supplies – expense when purchased
  - b. MSN – Non-incident materials and supplies – expense when consumed
  - c. MSR – Rotable and emergency spare parts – deductible when disposed of

## REPAIRS

8. Identify repairs to UOP that is a building
  - a. Determine if any of the safe harbors apply to the repair.
    - i. Eligible for the de minimis safe harbor?
    - ii. Eligible for the Safe Harbor for Small Taxpayers:
      1. Is their average annual gross receipts for past 3 years, \$10 million or less or
      2. Is the adjusted basis \$1 million or less?
    - iii. Eligible for Safe Harbor for Routine Maintenance?
      1. Recurring activity on a building to be performed more than once over 10 years
      2. Recurring activity to tangible property more than once over ADS class life
  - b. Run the repair through the multi-step test to determine if it is a:
    - i. Betterment
      1. Capitalize if corrects a material condition that existed prior to acquisition
      2. Capitalize costs that represent a material increase to the size, capacity, efficiency, strength or quality of a UOP, a building system or a segment of a UOP that performs its own critical and discrete function.
    - ii. Restoration
      1. Capitalize cost to repair or replace part of a UOP if basis was adjusted
      2. Capitalize cost to repair an asset after the end of its class life
      3. Capitalize cost to replace a part of a UOP and that part was either a major component or significant portion of either the UOP, a building system or a segment of a UOP that performs its own critical and discrete function.
    - iii. Adaptation for New or Different Use

## CAPITAL ASSETS

9. Review the asset lives and identify corrections, if necessary.
  - a. Identify changes to the depreciation method
  - b. Identify changes to the useful life

## LATE PARTIAL DISPOSITION OF ASSETS

10. Review the depreciation report and identify assets that replaced a component of a larger asset. This applies to items that must be capitalized because they cannot be expensed under other provisions.
  - a. If the larger asset is fully depreciated, capitalize the replacement or repair. Do not complete a partial disposition.
  - b. Determine the cost, depreciation taken and remaining basis of the replacement or repair.
  - c. Use any reasonable method to allocate the cost to the replacement or repair. Discount the cost of a similar replacement to its placed-in-service year cost using the “Producer Price Index”.
  - d. Record a disposition write-off which is the net of the cost less depreciation allowed or allowable.

## PRELIMINARY REVIEW OF 3115

11. Determine what needs to be done for the client and if an extension is required.
  - a. Receive a request to review client's return to determine if they will be impacted by TPR.
    - i. Print out email, if review is requested by the client. Print out the depreciation reports. Place inside the folder. Place the folder in the 3115 bin for a preliminary review.
    - ii. Make a quick determination of whether Form 3115 will be required or not.
    - iii. If Form 3115 is required, decide if it needs to be extended. If yes, consider whether a safe harbor estimate will be required.
    - iv. Complete the Tax Return Reminder with findings.
    - v. Return to person corresponding with the client.
  - b. Update AWS.
    - i. Enter a comment in the tax return stating what needs to be done (Form 3115 not required/required, Elections needed)
    - ii. If Form 3115 is required, add the task to Other Filings.
    - iii. If it is to be extended, click the extension requested box.
    - iv. If a safe harbor estimate will be required, add to Other Filings.
    - v. Place Tax Return Reminder on the right hand side of the tax folder.
  - c. Place the folder in the appropriate bin.
    - i. Form 3115 To Be Completed if required
    - ii. In Central Files if we do not have the information
    - iii. Appropriate Work In Progress bin if we have the tax information

## SEQUENCE OF ACTIVITIES

For business returns requiring Form 3115, complete the detailed analysis for Form 3115 before the fixed asset portion of the financial statement compilation is completed. Do not complete Form 3115 until the tax return is completed.

For individual returns requiring Form 3115, complete the detailed analysis before preparing the return.

For all returns, the 3115 will be completed last.

## COMPLETION OF FORM 3115 -

12. Complete the detailed analysis of the 481(a) adjustments for federal, AMT and state.
  - a. Create an Excel spreadsheet to assist if there are numerous assets.
  - b. Using Abby Scan to Excel, create an MS Excel worksheet from the depreciation report.
  - c. Add columns for federal prior depreciation (including Sec. 179 and accelerated depreciation), AMT prior depreciation and state prior depreciation.
  - d. Add a column for the adjustment type. Sort and enter formulas for the totals by adjustment type.
  - e. Add a column for federal, AMT and state 481(a) adjustments.
  - f. Print the Asset Life History to obtain methods and prior depreciation by year before adjusting or disposing of the asset.
  - g. Update ProSeries to reflect the decision to change the method of depreciation.
    - i. Delete assets if it is to be expensed.
    - ii. If it is an improvement (must be capitalized), change the description of the repair to include one of the following words:

1. Betterment
  2. Adaptation
  3. Restoration
  - iii. Add new assets.
  - iv. Make late partial disposals of assets.
  - h. Make the adjustment to the assets (basis, life, method) and reprint the Asset Life History.
  - i. After all adjustments are completed, print out the depreciation report.
  - j. Attach the reports to each 481(a) worksheet for use in calculating the adjustment.
13. Complete form 481(a) adjustment worksheet. Print a copy of the worksheet for use in preparing form 3115. If there are no 481 adjustments, form 3115 is not required.
14. If there are 481 adjustments, complete Form 3115.
  - a. Combine positive 184, 186, 187 and 192 adjustments on one form 3115.
  - b. Combine negative 184, 186, 187 and 192 adjustments on one form 3115.
  - c. Combine 196 or 205 on a separate form 3115 (late partial dispositions and general asset account dispositions)
  - d. Place this in the tax folder for use in the review process.
15. Complete the elections. See attached samples:
  - a. De Minimis Safe Harbor Election
  - b. Safe Harbor Election for Small Taxpayers (real property)
  - c. Safe Harbor Election for Routine Maintenance if you elect to capitalize repairs
16. Enter the adjustments in the tax return.
  - a. Enter the 481(a) adjustment on the appropriate schedule in the Other Expense worksheet. Enter the description:
    - i. De Minimis safe harbor asset(s)
    - ii. Safe Harbor Election for repairs, maintenance and improvements
    - iii. 481(a) adjustments
  - b. Enter the difference between the federal 481(a) and state 481(a) adjustment amounts on the ProSeries Activity Worksheet, Part II, Regular Income/Loss as an "Other Adjustment".

17. Complete the Power of Attorney for the taxpayer and spouse. Attach a copy of the pre-signed second page. The client will sign and print their name.

to represent the taxpayer before the Internal Revenue Service and perform the following acts:

**3 Acts authorized (you are required to complete this line 3).** With the exception of the acts described in line 5b, I authorize my representative(s) to receive and inspect my confidential tax information and to perform acts that I can perform with respect to the tax matters described below. For example, my representative(s) shall have the authority to sign any agreements, consents, or similar documents (see instructions for line 5a for authorizing a representative to sign a return).

| Description of Matter (Income, Employment, Payroll, Excise, Estate, Gift, Whistleblower, Practitioner Discipline, PLR, FOIA, Civil Penalty, Sec. 5000A Shared Responsibility Payment, Sec. 4980H Shared Responsibility Payment, etc.) (see instructions) | Tax Form Number (1040, 941, 720, etc.) (if applicable) | Year(s) or Period(s) (if applicable) (see instructions) |
|--|--|---|
| Income   | 1040   | 2014  |
| Change of Accounting Method  | 3115   | 2014  |

18. The return is ready for review. Reviewers checklist in addition to normal review procedures:
  - a. Review the preliminary depreciation report to verify analysis conclusion is correct
  - b. Review the 481(a) worksheets
  - c. Review form 3115
  - d. Reconcile the adjustments to the tax return

- e. Review the final depreciation report to verify that all adjustments were made to the fixed asset records.
  - f. Check to see if elections were completed
  - g. Review power of attorney
19. Place the TPR forms and documents in a plastic sleeve in the left hand pocket.
- a. Form 3115 with 481(a) worksheets.
  - b. Power of Attorney
  - c. TPR Supporting Documents
  - d. Engagement Letter Addendum
  - e. Place the folder in the “To Be Processed” bin.

## ASSEMBLY PROCEDURES

1. Assemble the tax return as normal. Leave the 3115 forms in the pocket. Scan the tax return per the standard procedures. The tax return – client copy will include all TPR forms also.
2. During the pickup appointment, we will obtain signatures for:
  - a. Form 3115, first page
  - b. Power of Attorney
  - c. Engagement Letter Addendum
  - d. Make a copy of the first page of the signed 3115 and give to client.
3. After the pickup appointment:
  - a. Return with elections only
    - i. Scan the source documents for the TPR and name 201X ABCD1234 TPR Documents.
    - ii. Scan the signed engagement letter and name as 201X ABCD1234 TPR Engagement Letter Addendum.
    - iii. Scan the elections and name as 201X ABCD1234 TPR Elections.
    - iv. Place in the eFile or Waiting for Signature bin.
  - b. Return with Form 3115
    - i. Scan the source documents for the TPR and name 201X ABCD1234 TPR Source Documents.
    - ii. Scan the signed power of attorney. Place a copy and place behind the 3115.
    - iii. Scan Form 3115, 481(a) worksheets and Power of Attorney and name as 201X ABCD1234 TPR Signed Form 3115 and Attachments. Leave them in the sleeve in the folder.
      1. Christine will attach the pdf file to the tax return and eFile the return.
      2. After the return has been acknowledged, place the Form 3115 sleeve in the wicker out basket.
      3. Mail the paper copy of Form 3115 with 481(a) worksheets and Power of Attorney to Ogden, UT. Send it certified.
    - iv. Fax the Power of Attorney to appropriate location using the instructions printed with Form 2848. After faxing, shred the POA.
    - v. Shred the source documents.