American Institute of CPAs
1455 Pennsylvania Avenue, NW
Washington, DC 20004-1081

April 17, 2012

Internal Revenue Service
Attention: CC:PA:LPD:PR (REG-168745-03)
Room 5203
P.O. Box 7604
Benjamin Franklin Station
Washington, D.C. 20044

Filed Electronically via the Federal eRulemaking Portal

RE: Comments on Proposed and Temporary Regulations under Sections 162(a), 168, and 263(a) Regarding Deduction and Capitalization of Expenditures Related to Tangible Property (REG-168745-03 and TD 9564) and Revenue Procedures 2012-19 and 2012-20

Dear Sir or Madam:

The American Institute of Certified Public Accountants (AICPA) is writing in response to Notice of Proposed Rulemaking (REG-168745-03)[1] and Temporary Regulations (TD 9564),[2] which request comments regarding proposed and temporary regulations under sections 162(a), 168, and 263(a) of the Internal Revenue Code, relating to the deduction and capitalization of expenditures related to tangible property. These comments were developed by the Repair Regulations Task Force of the AICPA's Tax Methods and Periods Technical Resource Panel, and approved by the Tax Executive Committee.

The AICPA is the national professional organization of certified public accountants comprised of approximately 377,000 members. 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.

[1] http://www.gpo.gov/fdsys/pkg/FR-2011-12-27/pdf/2011-32246.pdf.
[2] http://www.gpo.gov/fdsys/pkg/FR-2011-12-27/pdf/2011-32024.pdf.

Set forth below are the AICPA's initial comments on portions of the proposed and temporary regulations under sections 162(a), 168, and 263(a) in response to Notice of Proposed Rulemaking by cross-reference to temporary regulations (REG-168745-03 and TD 9564) and Revenue Procedures 2012-19 and 2012-20, pertaining to the deduction and capitalization of expenditures related to tangible property. The AICPA will be submitting additional comments to the government shortly.

Executive Summary

In general, the AICPA comments and submits recommendations on the following issues raised by the temporary regulations:

A. Administrative Burden / Complexity

The AICPA is concerned that the overall approach in the temporary regulations relies too heavily on a "facts and circumstances" based approach and contains too few bright line tests to alleviate administrative burden and complexity in the capitalization area. Although the AICPA might view a modest increase in administrative burden as an acceptable tradeoff for a simplified set of rules, the AICPA believes that, taken as a whole, the temporary regulations impose additional administrative burdens without eliminating the often controversial aspects of applying general capitalization principles.

B. Amounts Paid to Acquire or Produce Tangible Property, De Minimis Rule – Temp. Treas. Reg. § 1.263(a)-2T(g)

The AICPA believes the requirement that a taxpayer have an applicable financial statement (AFS) to use the de minimis rule unfairly discriminates against smaller taxpayers, and recommends an alternative test to allow such taxpayers to use the de minimis rule. Additionally, the AICPA believes that if a taxpayer's capitalization threshold is appropriate for financial reporting purposes, then conforming to that threshold for federal income tax purposes would not result in a distortion of the taxpayer's taxable income. Accordingly, the AICPA recommends the ceiling be removed for those taxpayers that have AFSs and meet the other requirements of the temporary regulations.

C. Method Change Rules – Revenue Procedures 2012-19 and 2012-20

The AICPA recommends that the method change rules for the de minimis rule and late general asset account (GAA) elections be clarified. Additionally, the AICPA believes that the goal of reduced controversy involving tangible property capitalization issues will be best served if taxpayers are permitted to use an extrapolation method in conjunction with the statistical sampling methodology. Finally, the AICPA recommends that the accounting method change guidance include examples illustrating how the guidance should apply for multiple interrelated changes.

Each of these areas is addressed in detail below.

A. Administrative Burden / Complexity

The AICPA commends the Department of the Treasury (Treasury) and the Internal Revenue Service (IRS) for their continued efforts to produce administrable capitalization guidance and for their responsiveness to concerns raised by the AICPA and other commentators throughout the development process. Subject to the comments about specific provisions discussed below, the AICPA believes the temporary regulations will help taxpayers appropriately apply the capitalization principles. However, the AICPA is concerned that the overall approach in the temporary regulations relies too heavily on a "facts and circumstances" based approach and contains too few bright line tests to alleviate administrative burdens and complexity in the capitalization area.

For example, with respect to elections, one way the temporary regulations could ease significant administrative burden and potential traps for the unwary would be to make the GAA election the default rule such that an affirmative election statement would only be required if the taxpayer does not want to make a GAA election. Because the new operating rules for GAAs permit taxpayers to elect to either continue depreciation or discontinue depreciation and recognize gain or loss for any or all dispositions from such an account, it would appear that taxpayers have little if any incentive to not make a GAA election. This situation is similar to the election under section 195 to amortize start-up costs. In the final regulations under section 195, Treasury converted what had previously been an affirmative election requirement to the default rule based on the understanding that most taxpayers would prefer to amortize start-up expenditures and very few would prefer to have no amortization.

The AICPA believes that certain provisions are well suited to minimize compliance efforts, but that benefit is offset by administrative demands in other provisions of the regulations. In the context of the routine maintenance safe harbor, for example, the AICPA appreciates that Temp. Treas. Reg. § 1.263(a)-3T(g)(4) equates the class life of a unit of property under the alternative depreciation system (ADS) with the testing period for the maintenance activities. As the Treasury and IRS correctly noted in the preamble:

> The class life based standard is more objective, is more consistent among taxpayers, and is more administrable than a standard based on the economic useful life of the property.

But in other instances, the temporary regulations require an inquiry into the economic useful life of property, such as in the definition of materials and supplies under Temp. Treas. Reg. § 1.162-3T(c). The regulations thus adopt an admittedly less administrable standard and contemplate that – for a taxpayer without a useful life established for depreciation purposes on an AFS – an economic useful life would be determined and substantiated where no such record is maintained for book purposes. Although the administrative demands to gather and assess particular information might seem minimal when viewing a capitalization rule in isolation, the AICPA believes that the combined administrative burdens for all of the provisions make compliance with the temporary regulations difficult.

Although the AICPA might view a modest increase in administrative burdens as an acceptable tradeoff for a simplified set of rules, the AICPA believes that, taken as a whole, the temporary regulations impose additional administrative burdens without eliminating the often controversial aspects of applying general capitalization principles. As a result, taxpayers and their advisers face the additional task of complying with a complex set of regulations where the regulations themselves continue to require many of the same controversial facts-and-circumstances based determinations that the guidance was intended to address. For example, the temporary regulations still require a consideration of all the facts and circumstances to identify facilitative transaction costs under Temp. Treas. Reg. § 1.263(a)-2T(f)(2), to determine a unit of property for network assets under Temp. Treas. Reg. § 1.263(a)-3T(e)(3)(iii)(B), to aggregate related amounts for an improvement under Temp. Treas. Reg. § 1.263(a)-3T(f)(4), to qualify for the routine maintenance safe harbor under Temp. Treas. Reg. § 1.263(a)-3T(g)(1), to identify a betterment under Temp. Treas. Reg. § 1.263(a)-3T(h)(3), and to determine whether a replacement comprises a major component or substantial structural part of a unit of property under Temp. Treas. Reg. § 1.263(a)-3T(i)(4). The AICPA believes that, where the temporary regulations merely incorporate the contentious facts-and-circumstances determinations from case law and prior guidance, the need to make those determinations plus the obligation to comply with all of the other requirements in the temporary regulations is overly burdensome.

The AICPA accordingly is concerned that the temporary regulations impose too many administrative burdens in their entirety. At a minimum, the complex set of rules with many interrelated aspects contained in the nearly two hundred fifty pages that were released on December 23, 2011, and the additional nearly one hundred pages of procedural guidance released in March 2012 will require taxpayers and their advisers to devote significant resources annually in order to understand and apply the rules. Unfortunately, substantial effort is required to apply the nuanced rules to non-abusive, commonplace transactions such as the purchase of a supply item. The AICPA thinks that the complex nature and administrative burden of the temporary regulations might lead to noncompliance. Therefore, the AICPA strongly encourages the Treasury and IRS to reconsider the general approach of this guidance. The AICPA appreciates the tremendous efforts that have gone into this project so far; however, the AICPA believes that the guidance cannot be effective without adopting a simplified approach to capitalization that minimizes the accompanying compliance demands. Because this guidance will affect nearly every business taxpayer, the AICPA believes a reconsideration of the overall approach is warranted to prevent, as noted in the preamble to the regulations, "[t]he standards for applying section 263(a), as set forth in the regulations" from becoming "difficult to discern and apply in practice" and creating "considerable uncertainty and controversy for taxpayers." Our concerns with the overall approach have brought to the forefront the following areas which are of immediate concern to our members. Additional comments in other areas are currently in development and expected to be submitted to the government shortly.

B. Amounts Paid to Acquire or Produce Tangible Property, De Minimis Rule – Temp. Treas. Reg. § 1.263(a)-2T(g)

1. Taxpayers without an AFS

In its comments submitted for the 2008 proposed regulations, the AICPA recommended that eligibility to use the de minimis rule not be predicated on the existence of an AFS.[3] This requirement unfairly discriminates against smaller taxpayers, as smaller taxpayers are less likely to have a financial statement that meets the definition of an AFS. The AICPA believes that all taxpayers, not just those with an AFS, should be eligible for the de minimis rule. For taxpayers without an AFS, the AICPA proposed a modified version of what was the safe harbor in the 2008 proposed regulations. Specifically, the AICPA proposed that for taxpayers without an AFS, the de minimis capitalization threshold would be deemed to not distort taxable income if the amount deducted was less than or equal to 0.1 percent of the taxpayer's average annual gross receipts reported on its federal income tax returns for the three taxable years immediately prior to the current taxable year (or, if shorter, the taxable years during which such taxpayer was in existence), with operative rules similar to those under sections 448 and 460.

The AICPA believes that its prior proposal for taxpayers without an AFS is equally applicable under the de minimis rule included in the temporary regulations, and can be applied as a ceiling amount (if the ceiling is retained). Specifically, the AICPA recommends that the de minimis rule be permitted for a taxpayer without an AFS, but that otherwise satisfies the requirements of having a written capitalization policy as of the first day of the taxable year that is used for book accounting purposes, which policy the taxpayer follows for book accounting, provided the amount expensed under such written policy does not exceed 0.1 percent of the taxpayer's tax gross receipts for the taxable

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[3] http://www.aicpa.org/InterestAreas/Tax/Resources/TaxMethodsPeriods/Advocacy/DownloadableDocuments/AICPA_02_22_2011_tangibles_comments.pdf, AICPA comment letter dated February 22, 2011.

year. The AICPA believes this approach is fairer to small taxpayers and addresses the concerns of the government.

2. Definition of Tax Gross Receipts

The temporary regulations provide a ceiling on the amount that may be deducted under the de minimis rule. Such ceiling is equal to the greater of – (1) 0.1 percent of the taxpayer's gross receipts for the taxable year as determined for federal income tax purposes, or (2) 2 percent of the taxpayer's total depreciation and amortization expense for the taxable year as determined in its AFS.[4] If the ceiling amount is retained in the final regulations, the AICPA suggests that the final regulations include a definition for "gross receipts" for purposes of applying the ceiling. Specifically, the AICPA recommends the final regulations provide that "gross receipts" for such purpose be determined in accordance with Temp. Treas. Reg. § 1.448-1T(f)(2)(iv)(A) or Treas. Reg. § 1.263A-3(b).

3. Administrability of the De Minimis Rule

The AICPA believes a de minimis rule is essential in any capitalization guidance aimed at reducing controversy. However, the AICPA is concerned that the de minimis rule included in the temporary regulations, and particularly the ceiling on the deductible amount, does not take into account how taxpayers account for items expensed under a book minimum capitalization threshold policy. Specifically, taxpayers generally do not have a single account through which amounts expensed under a capitalization policy are tracked, nor do taxpayers maintain records of the items expensed under such policy. To require taxpayers to capitalize amounts for which they maintain no detailed records, based on an arbitrary ceiling amount that is determined as of the end of the tax year in which the expenditures are made, is simply not administrable for taxpayers.

A company establishes a minimum capitalization threshold policy so as to obviate the need to track small dollar expenditures. The de minimis rule ceiling test, computed after the end of the tax year, effectively requires taxpayers to maintain the exact type of information a minimum capitalization threshold is intended to eliminate. The AICPA believes that the inclusion of the ceiling in the final regulations will increase audit controversy and create uncertainty and additional recordkeeping requirements for taxpayers. The AICPA believes that if a taxpayer's capitalization threshold is appropriate for financial reporting purposes, then conforming to that threshold for federal income tax purposes does not result in a distortion of the taxpayer's taxable income.

In addition to the concerns raised above, the presence of a ceiling in the regulation may result in the unequal treatment of similarly situated taxpayers. Specifically, the preamble

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[4] Temp. Treas. Reg. § 1.263(a)-2T(g)(1)(iv).

states that the intent of IRS and Treasury is to allow taxpayers to deduct amounts in excess of the ceiling if the result clearly reflects income or is the subject of a prior agreement with the taxpayer's examination team. The AICPA believes there is no policy justification to treat taxpayers who do not have a written agreement less favorably than those who do. Accordingly, the AICPA recommends the ceiling be removed.

If the ceiling is retained in the final regulations, the AICPA recommends that taxpayers be permitted to use the sampling procedures provided under Rev. Proc. 2011-42,[5] to determine whether the ceiling has been exceeded. Additionally, if the final regulations include a ceiling, the AICPA recommends that the default treatment for any amounts exceeding the ceiling be capitalization, rather than requiring the taxpayer to affirmatively elect capitalization. This eliminates the so-called "cliff effect" under the present language. This would also eliminate potential controversy if on examination it is determined the capitalization threshold deduction for AFS purposes exceeded the ceiling limitation.

C. Method Change Rules – Revenue Procedures 2012-19 and 2012-20

The AICPA commends the IRS and Treasury for providing automatic method changes to comply with the temporary regulations. Additionally, the AICPA believes the waiver of the scope limitations for two years will allow taxpayers additional time to comply with the complex rules provided in the temporary regulations. However, the AICPA has identified a number of areas that should be revised or clarified.

1. <u>Change in Accounting Methods for the De Minimis Rule</u>

Under Rev. Proc. 2012-19, a taxpayer receives automatic consent for a change to the de minimis rule. However, it is not clear whether if a taxpayer currently using a method that is consistent with the de minimis rule in Temp. Treas. Reg. § 1.263(a)-2T(g) is required to file a method change. Additionally, it is not clear whether a taxpayer that changes its book minimum capitalization amount is required to request consent to change its method of accounting, even though it continues to employ the de minimis rule as set forth in Temp. Treas. Reg. § 1.263(a)-2T(g). The AICPA suggests that the government provide guidance that a change in the book minimum capitalization amount is not a change in method of accounting. If, however, the government determines that a taxpayer's change in its book minimum capitalization threshold is a change in accounting method, the AICPA recommends that the change be implemented on a cut-off basis, and by including a statement in the taxpayer's return in lieu of filing a Form 3115, *Application for Change in Accounting Method*.

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[5] 2011-2 C.B. 318.

The AICPA is also aware of a number of taxpayers that would be eligible for the de minimis rule, but for the requirement of having a written capitalization policy in effect on the first day of the taxpayer's taxable year. The AICPA suggests that the government consider providing transitional relief to comply with the written policy provision for a taxpayer's first taxable year beginning after December 31, 2011. If such relief is not granted, the AICPA recommends that the government clarify whether a taxpayer that had not previously deducted amounts under a minimum capitalization policy that was precluded from the changing to the de minimis rule solely by virtue of not having a written capitalization policy as of the first day of its taxable year, must file an accounting method change or would be considered to adopt a method of accounting because of a change in underlying facts.

2. <u>Permit Extrapolation under the Sampling Rules</u>

The AICPA commends the IRS and Treasury for specifically permitting the use of statistical sampling (in accordance with Rev. Proc. 2011-42) in computing the section 481(a) adjustment and the amount of the item in determining taxable income for a number of items subject to the temporary regulations, and does not prohibit the use of statistical sampling for any adjustment. Given that one of the primary goals of the temporary regulations is to minimize controversy over tangible property capitalization issues, the AICPA believes this goal would be furthered if extrapolation procedures were permitted as an alternative. Examples of permissible extrapolation procedures are provided in Rev. Proc. 2011-43[6] (concerning a safe harbor method for utility transmission and distribution property) and Treas. Reg. § 1.263A-7(c) (concerning revaluation of inventory costs under the uniform capitalization rules). The need for extrapolation procedures is evident because of the long-lived nature of many fixed assets subject to the temporary regulations, coupled with the fact that many taxpayers have undergone fixed asset system changes in the recent past, and may find it impractical or impossible to obtain accurate data as far back as necessary to perform a statistical sample study within the guidelines of Rev. Proc. 2011-42.

3. <u>Additional Items</u>

a. Clarify intent – "should" vs. "must" file a single Form 3115

Section 4.02(1) of Rev. Proc. 2012-19, adding new Appendix section 3.10, states at 3.10(4)(b) that "A taxpayer that wants to make this change and a concurrent change to a method under §§ 1.162-3T, 1.162-4T, 1.263(a)-1T, 1.263(a)-2T, or 1.263(a)-3T with the same year of change ***must*** file a single Form 3115 that includes all of the concurrent method changes." [Emphasis added.] Section 4.02(1) of Rev. Proc. 2012-19, adding new Appendix section 3.11, states at 3.11(3)(b) that "A taxpayer that wants to make this

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[6] 2011-37 I.R.B. 326.

change and a concurrent change to a method under §§ 1.162-3T, 1.162-4T, 1.263(a)-1T, 1.263(a)-2T, or 1.263(a)-3T with the same year of change ***should*** file a single Form 3115 that includes all of the concurrent method changes." [Emphasis added.] The AICPA believes that the seemingly contradictory language in Rev. Proc. 2012-19 creates confusion and uncertainty as to whether a taxpayer has a valid method change. Accordingly, the AICPA requests that the procedural guidance clarify that a taxpayer need not file a single Form 3115 with all method changes made under Rev. Proc. 2012-19. Many taxpayers have indicated a desire to file more than one of the types of changes that may be combined, but need to spread out the workload over time and therefore would prefer to file the Forms 3115 in a serial fashion rather than all at once. If the government prefers a taxpayer to file a single Form 3115 for all method changes made under Rev. Proc. 2012-19, the AICPA suggests that the revised revenue procedures include examples of the information required, as well as the computation of the respective section 481(a) adjustments, if any.

b. GAA elections and concurrent qualified disposition method change

The guidance in Rev. Proc. 2012-20 is unclear regarding how many Forms 3115 need to be filed when a taxpayer wants to change to a method of accounting to make a late GAA election[7] for an item of modified accelerated cost recovery system (MACRS) property and a method change to recognize a loss upon the prior disposition of an asset that was once part of the same item of MACRS property. The need for additional guidance can be illustrated by applying the rules as currently written to the following factual situation:[8]

- In 1990, Taxpayer places a building and its structural components into service and does not make a GAA election with respect to the building or its structural components.
- In 2000, Taxpayer replaces the entire roof on the building. Taxpayer did not recognize a loss on the retirement of the old roof and continues to depreciate the original roof. Taxpayer also capitalized the cost of the replacement roof and has been depreciating this roof under section 168 since 2000.
- In 2012, Taxpayer wants to file a change in method of accounting to make a late GAA election for the building and its structural components.
- In 2012, Taxpayer also wants to file a change in method of accounting to change from depreciating the original roof to recognizing a loss upon its retirement.

[7] New section 6.32(1)(a)(i) of Rev. Proc. 2011-14.
[8] Based on new section 6.29(4)(a) *Example 1* of Rev. Proc. 2011-14.

As Rev. Proc. 2012-20 is currently written, it is unclear whether a taxpayer may make both a late GAA election for property placed in service prior to 2012 and also claim a section 481(a) adjustment for a prior disposition of a component of the property on the same Form 3115. Similarly, if there were multiple prior dispositions of components of the property, it is unclear whether the taxpayer may only recognize a loss on some dispositions but not others as part of the same method change and section 481(a) adjustment. The AICPA believes the procedural guidance should clearly indicate which GAA and disposition method changes may be implemented together and pursuant to which automatic change number.

c. Provide examples to illustrate method change rules

As illustrated in the preceding section, taxpayers must be cognizant of the interrelationships among the various provisions in the temporary regulations, as well as the interrelationships among the various method changes necessary to comply with such regulations. Because of the interrelationship between changes made pursuant to Rev. Proc. 2012-19 and those made pursuant to Rev. Proc. 2012-20, and even changes within the revenue procedures, the AICPA suggests that the government provide examples of how such interrelationships are to be determined for purposes of effectuating the method changes necessary to comply with the temporary regulations.

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We appreciate your consideration of our recommendations, and we welcome further discussion of the comments. If you have any questions, please contact Jane Rohrs, Co-chair, AICPA Repair Regulations Task Force at (202) 370-2290, or jrohrs@deloitte.com; Natalie Tucker, Co-chair, AICPA Repair Regulations Task Force at (904) 680-7209, or natalie.tucker@mcgladrey.com; Carol Conjura, Chair, AICPA Tax Methods and Periods Technical Resource Panel at (202) 533-3040, or cconjura@kpmg.com; or Michelle R. Koroghlanian, AICPA Technical Manager at (202) 434-9268, or mkoroghlanian@aicpa.org.

Sincerely,

Patricia A Thompson

Patricia A. Thompson, CPA
Chair, AICPA Tax Executive Committee

cc: Andrew Keyso, Jr., Associate Chief Counsel (Income Tax & Accounting), Internal Revenue Service
Scott Dinwiddie, Special Counsel to the Associate Chief Counsel (Income Tax & Accounting), Internal Revenue Service

Merrill Feldstein, Senior Counsel, Income Tax and Accounting, Branch 3, Internal Revenue Service
Alan S. Williams, Attorney, Income Tax and Accounting, Branch 3, Internal Revenue Service
Kathleen Reed, Branch Chief, Income Tax and Accounting, Branch 7, Internal Revenue Service
Patrick Clinton, Assistant to the Branch Chief, Income Tax and Accounting, Branch 7, Internal Revenue Service