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IRS Revenue Procedure 2011-14: Impact on Section 179D for Designers of Municipal Projects

Revenue Procedure 2011-14 allows certain taxpayers to claim the §179D deduction for open and closed tax years without filing amended tax returns.

The designers of municipal building projects: Public schools, government and municipal buildings (public buildings) are eligible to claim the §179D tax deduction for sustainable design. The §179D tax deduction was created as part of the Energy Policy Act of 2005 and was intended as an incentive for designers to incorporate energy-efficient building components in their designs. Notice 2006-52 and Notice 2008-40 provide details of the guidelines for claiming the §179D deduction. Rev. Proc. 2011-14, deals with automatic consent for a change in accounting method.[i]

Until recently, firms were limited by the §6511 three year statute of limitations to claim the §179D deduction on amended income tax returns for a particular tax year. The inclusion of §179D in Revenue Procedure 2011-14, will allow some taxpayers to claim this deduction for open (prior three years) and closed tax years (statute of limitations has expired) without filing amended income tax returns. The Revenue Procedure requires a cumulative §481(a) adjustment to calculate the effect of the "change in accounting method" and this cumulative adjustment, in most, cases will be negative (a deduction) as it relates to the §179D deduction. Taxpayers utilizing this Revenue Procedure will get to take the entire "catch up" deduction on the tax return for the year of change! This is where qualifying designers should take note as this one year rule could result in a large tax benefit to their firm and its shareholders.[ii]

Taxpayers may file Form 3115, Application for Change in Accounting Method, with a timely filed return on or before the extended due date for the year of change. If you complete Form 3115 per the Revenue Procedure and form instructions, including the certification report and allocation letter required by Notices 2006-52 and 2008-40, you will receive automatic consent from the IRS to make this change. §179D, as you know, is applicable to buildings put in service or retrofitted after 12/31/2005. In most cases, claiming the §179D deduction on a Form 3115 will be the preferred method for firms seeking to maximize previous year's deductions as it involves less paper work and can pierce the statute of limitations.[iii]

If a firm has already claimed the deduction on timely filed or amended returns, their accounting method may be established and this relief may not be available. Additionally, Revenue Procedure 2011-14 leaves one question open to interpretation that could allow this Revenue Procedure to benefit taxpayers across a broad base of scenarios. Should each individual qualifying building be viewed as a separate item of accounting under §446 (and the related regulations) for purposes of the §179D deduction similar to the elections applicable to specific depreciable assets or should all qualifying buildings be viewed utilizing the aggregate theory as a single item of accounting under §446 for purposes of the §179D deduction?[iv]

Making the decision to apply for a change in accounting method is a complex process that cannot be adequately covered in this article. Special rules apply to taxpayers under examination or that have applied for a change during a sixty month period. Taxpayer should seek competent advice if they think that they may benefit from this Revenue Procedure. Considering the potential impact that this change can provide for designers they will want to consider all the potential outcomes.[v] Many factors must be taken into account including taxable income and tax rates for each prior year, the potential value of the closed year's deductions, and the potential taxable income and tax rates for prospective years if the current year §481(a) adjustment would create some type of carryover. I encourage potential beneficiaries to take into account all tax years and the impact that §179D may have on other return items, while considering the total potential benefit for the entire period that these calculations may effect.

IRS Circular 230 Disclosure

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[i] It supersedes Rev. Proc. 2008-52 and modifies Rev. Proc. 97-27, and is effective for applications filed on or after January 10, 2011, for a year of change ending on or after April 30, 2010.

[ii] However, it is important to note that in the unlikely event of a positive (income) adjustment the taxpayer is required to spread the total adjustment ratably over four years in most cases, with exceptions.

[iii] For this item if you did not complete your studies in time to file a timely or amended income tax return for tax year 2006 alone or in combination with other years.

[iv] If each individual building could be considered a separate item for the §179D deduction, then each building or group of buildings may have a separate method of accounting. In this case, the §179D deduction could be applied on a building by building basis, each building being a material item as defined under §446. An accounting method change would not be appropriate for buildings where §179D was previously taken because no change would be required. The taxpayer could adopt a new method of accounting for §179D for a specific building or group of buildings where no §179D deduction had previously been taken. It would also be appropriate to consider the cumulative allowable §179D deductions for that particular building including closed years in computing the §481(a) adjustment that would result from this cumulative calculation. However, if all buildings were viewed as a single item under §446, then the §179D should be applied in the aggregate to all buildings. If a taxpayer has already taken the §179D deduction on any building, then they have likely adopted a method of accounting for §179D for all buildings and no accounting method change would be allowable (closed years not available). If the taxpayer has never taken a §179D deduction on any building, then the adoption of §179D by the taxpayer would be for all qualifying buildings. In computing the §481(a) adjustment, it would be appropriate to consider the cumulative allowable §179D deductions for all qualifying buildings (including closed years).

Applying §179D on a building by building basis is the most logical approach when compared to the guidance available for depreciation methods. However, the IRS did not provide additional guidance on this issue along with the new Revenue Procedure. Further clarification may be necessary and is likely as applications begin to be processed.

[v] For example, amending open returns and leaving closed returns alone versus applying the Revenue Procedure and making a cumulative adjustment in the year of change for all prior years regardless of the statute of limitations.