Tangible Property Regulations: CFC Compliance and Opportunities Assessment

The Tangible Property Regulations (TPR) present controlled foreign corporations (CFCs) with the same compliance risks and opportunities afforded their domestic parents. The potentially severe consequences of improperly computing a CFC's E&P means domestic parents should pay close attention to how their CFCs are implementing these important new rules. Because the rules governing costs to acquire, repair, and maintain tangible property are mandatory beginning with 2014 tax years, this review should begin right away.

The regulations include both final capitalization regulations and proposed disposition regulations. These regulations create potential planning opportunities for domestic parents. In many cases, the rules are implemented as accounting method changes with a "catch up" section 481(a) adjustment. Taxpayer-favorable adjustments (essentially a deduction taken in a single year) could be helpful for CFC's looking to decrease E&P, while taxpayer-unfavorable adjustments (generally a four-year spread of additional income) could increase E&P. While the proposed disposition regulations will not be mandatory until finalized (hopefully later this year), they may be "early adopted" for 2013 tax years using the automatic accounting method change procedures.

Key Considerations

Book Capitalization Election. CFCs can elect annually to capitalize for tax purposes all repair and maintenance costs capitalized that year for book purposes. Once made, this election is irrevocable for that year, but will not affect the company's treatment of similar costs in later years. The book conformity election is not an accounting method and does not require a review of the company's treatment of repair and maintenance costs in prior years. Because it is not an accounting method, this option allows the domestic parent to decide each year whether to make the safe harbor election, or instead to obtain the greater precision available by applying the regulations' default rules. Even with a safe harbor election, the CFC still must ensure that any repair costs deducted for book (and tax) purposes are properly expensed under the TPR as well. Nonetheless, this election is an attractive option for parent companies who prefer not to perform a close review of their CFC's repair and maintenance costs (e.g., because data is not readily available in an accessible format), while still ensuring that the CFCs adhere to the TPR requirements.

De Minimis Costs. CFCs can elect annually to deduct for tax purposes certain "de minimis" costs that also are deducted under a written financial accounting policy. The ceiling is $5,000 per item for taxpayers having an "applicable financial statement" and $500 per item for those without an AFS. If a CFC's financial results are reported in the applicable financial statement (AFS) for a group of entities, the group's AFS may be treated as the CFC's AFS. Likewise, if the CFC follows the group's written accounting policies, that written procedure is treated as the CFC's procedure. Careful planning prior to the beginning of the CFC's tax year helps ensure that the company fully benefits from this new rule.

Routine Maintenance Safe Harbor. The CFC also may deduct the costs of many routine maintenance activities that it expects to perform more than once over the property's Alternative Depreciation System (ADS) recovery period (or over ten years for buildings). This new rule potentially is beneficial for all CFCs (and can help reduce compliance costs), but particularly so for those in capital intensive industries in which regular, planned maintenance is common, such as the energy industry.

Partial Dispositions. The TPR provide a completely revamped set of rules governing when a taxpayer may – or must – recognize gain or loss from the disposition of tangible property, including dispositions of only a portion of the property. The proposed rules – which we expect to be finalized without significant change – are complex and may be unfamiliar to many companies. Because they directly impact not only the CFC's depreciation expenses, but also whether and when it may deduct the costs of replacing the disposed property, companies should pay particularly close attention to these rules when computing the CFC's E&P once the rules become final. For CFC's that have not previously followed a disciplined "retirements" policy, there may be opportunities to immediately recover the remaining basis of property that was disposed of in earlier years by "early adopting" the proposed regulations using an accounting method change. The window for doing so, however, is limited.

How KPMG Can Help

KPMG has a team of professionals in our Accounting Methods and Credits Services practice and in our Washington National Tax group with a comprehensive understanding not only of the TPR, but also in the specialized accounting method rules applicable to CFCs. Our team can assist you in determining whether CFCs currently are compliant with the TPR, areas in which the CFCs can take better advantage of the rules, and in determining whether and how to make accounting method changes using the specialized procedures applicable to CFCs.

Because the window for making some of the required changes is limited, KPMG recommends undertaking a review of how the TPR affect your CFCs right away.

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