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LB&I audit guide under tangible property regulations

The IRS Large Business and International (LB&I) operating division has issued an “audit techniques guide” (ATG) providing guidance to IRS examination teams auditing taxpayer implementation of the tangible property regulations.

Read the [ATG](#) [PDF 935 KB] *Capitalization of Tangible Property: Treas. Reg. § 1.263(a) and related regulations*

KPMG observation

In general, the ATG contains few surprises. The document largely restates the basic rules of the tangible property regulations, and provides exam teams with instructions as to the issues they are likely to encounter and the information to request and consider in connection with audits of “repair studies.”

Audit techniques guide (ATG)—overview

The 202-page ATG contains 18 chapters, with guidance on the treatment of costs to acquire, produce, repair, or improve property; dispositions of tangible property; and the procedures for making accounting method changes required by the tangible property regulations.

The structure of the ATG generally follows that of the tangible property regulations, with separate chapters for the following topics:

- Examination of tangible property
- Compliance considerations
- Unit of property
- Amounts paid to acquire or produce property
- De minimis safe harbor

- Betterments
- Restorations
- New or different use
- Safe harbors—special rules—other provisions
- Materials and supplies
- Leased property
- Disposition concepts and MACRS accounting rules
- Dispositions in general
- MACRS disposition rules
- General asset account rules
- Accounting method changes
- Account method changes—capitalization
- Accounting method changes—depreciation and dispositions

Much of the ATG is devoted to providing exam teams with a basic primer on the rules, definitions, and safe harbors set forth in the tangible property regulations for each of these topics. The first chapter includes a useful glossary of the basic concepts and definitions used in the regulations, along with cross-references to the specific section of the regulations containing each rule or definition. The document also compiles information for each of the accounting method changes potentially required by the tangible property regulations and the procedures for making such changes. These compilations may prove useful to taxpayers as well as to LB&I employees.

Examples

In addition to relatively concise explanations, the ATG illustrates each of the core concepts of the tangible property regulations using one or more examples. In many cases, the examples are simplified versions of those already contained in the tangible property regulations. In some situations, though, the ATG provides new examples, providing additional insights or clarity regarding specific provisions. For instance, the ATG provides a new example regarding the identification of units of property and major components of “plant property.”

Instructions to exam teams

The ATG provides:

- Specific instructions to the exam teams for each of the foregoing topics, including for potential audit issues to be alert for
- Factors that should be weighed in assessing the audit risk of particular issues
- Specific interview questions that the exam team should pose to the taxpayer
- Documentation, computations, and fixed asset systems that the exam team should review
- Other specific examination considerations that should be included in the audit plan

For the most part, the examination techniques, questions, and areas of inquiry hold few surprises. The following elements of the ATG, however, are noteworthy:

- The ATG provides no further guidance for determining whether de minimis policies in excess of \$5,000 per item “clearly reflect” the taxpayer’s income.
- Taxpayers under audit for the treatment of costs to repair or maintain buildings should expect to be asked for copies of all “past and present” cost segregation studies—those studies themselves may be further examined.
- Examiners are provided no guidance for determining units of property for network assets for which there is not yet industry specific guidance (e.g., natural gas pipelines).
- Controversy is likely to continue in identifying “betterments.” For example, while the regulations generally permit a deduction for the replacement of a roof membrane, the ATG throws that conclusion into doubt in certain situations.
- The ATG’s discussion of dispositions in general and in identifying “assets” for purposes of dispositions in particular is unduly complex. The complexity of this discussion and the emphasis placed on the interaction of the disposition rules with the separate rules for repair and maintenance costs and for depreciation may result in additional uncertainty and controversy during IRS audits of these issues.

KPMG observation

For taxpayers currently under or anticipating being under audit for their implementation of the tangible property regulations, the ATG provides useful insights into the specific questions the IRS is likely to ask and the specific documentation the examiners likely will request and scrutinize. Although an ATG is just that—a guideline—exam teams likely will adhere closely to the suggested approaches to these audits, as the IRS builds its institutional understanding of the manner in which taxpayers implemented these regulations.

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