

Fixing Depreciation Errors By Making a Change in Method of Accounting

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This article explains how taxpayers can correct depreciation errors on their tax returns, specifically when depreciation was not claimed for eligible properties over multiple years. Instead of filing amended returns—which is usually limited by a three-year statute of limitations for refunds—taxpayers can claim missed depreciation by filing Form 3115 (Application for Change in Accounting Method) with their current year’s return. This process treats the correction as a change in accounting method.

INTRODUCTION

A new client comes into the office to have her tax returns prepared. She has been preparing her own returns for the past 10 years, during which time she has never claimed any depreciation for her three residential rental properties. She is entitled to depreciation for the portions of her rentals allocable to the buildings.

How is this fixed? Can she file amended returns for all 10 years to claim the missed depreciation deductions? Probably not, because there is a three-year statute of limitations on claiming a refund.¹

This article demonstrates that the missed depreciation for all 10 years can be claimed by filing Form 3115 (Application for Change in Accounting Method) with the current return.

CHANGE IN METHOD OF ACCOUNTING — IN GENERAL

The law requires taxable income to be computed under the method of accounting that the taxpayer regularly uses in his or her books.² Regulations provide that the term “method of accounting” includes not only the overall method of accounting, but also the accounting treatment of any material item, which includes “any item that involves the proper time for the inclusion of the item in income or the taking of a deduction.”³

To determine whether timing is involved, the question is usually whether the accounting practice permanently affects the taxpayer’s lifetime income or merely changes the taxable income for the particular year.⁴

In most instances a taxpayer must use a pattern of consistent treatment of a material item in order to establish a method of accounting.⁵ For this purpose, consistent treatment means treating the material item the same way in two or more consecutively filed tax returns.⁶

To claim depreciation that was missed on previous returns (“catch-up” depreciation), Form 3115 must be filed with a timely-filed return.

Once a method of accounting has been adopted, a taxpayer must secure the consent of the Commissioner before using a new method of accounting.⁷ For many changes in methods of accounting, the IRS provides “automatic consent.” These changes are listed in the Form 3115 instructions⁸ and in the annual IRS revenue procedure that lists such changes.⁹ Each type of change is represented by a Designated Change Number.

An “automatic consent” change is not allowed if the taxpayer’s return is being audited, if the taxpayer has ceased operating the business (except for certain automatic consent changes that are specifically allowed for the year in which the taxpayer has ceased operating the

business), or if the taxpayer made or requested a change for the same item during any of the five taxable years ending with the year of change.¹⁰

To make an “automatic consent” change, the taxpayer files Form 3115 with the return. The IRS does not require the taxpayer to pay any user fee for such a change.¹¹ There are also other changes in methods of accounting that are “non-automatic consent” changes. For these changes, the taxpayer must also file Form 3115, but must request a private letter ruling from the IRS and pay a user fee.¹²

DISTINCTION BETWEEN A CHANGE IN METHOD OF ACCOUNTING AND CORRECTION OF AN ERROR

A change in method of accounting is not the same as correction of an error. Sometimes, it is difficult to distinguish between a change in method of accounting and correction of an error. In regulations, the IRS has stated that the following adjustments are not treated as changes in method of accounting:

- A correction of mathematical or posting errors, or errors in the computation of tax liability (such as errors in computation of the foreign tax credit, net operating loss, percentage depletion, or investment credit).
- An adjustment of any item of income or deduction which does not involve the proper time for the inclusion of

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- the item of income or the taking of a deduction (such as corrections of items that are deducted but which are in fact dividends, and items that are deducted as business expenses but which are personal expenses).
- An adjustment with respect to the addition to a reserve for bad debts or an adjustment in the useful life of a depreciable asset.
- A change in treatment resulting from a change in underlying facts.¹³

Where a taxpayer is required to report income a certain way under a statute and erroneously reports it in a different way, changing this is a correction of an error, not a change in method of accounting.¹⁴

CHANGE IN DEPRECIATION AS A METHOD OF ACCOUNTING CHANGE

Regulations provide that a change in depreciation or amortization is generally a change in method of accounting.¹⁵ According to these regulations, the following changes in depreciation are changes in method of accounting:

- A change that results from treatment of an asset from nondepreciable or nonamortizable to depreciable or amortizable, or vice versa.
- A change that results from the depreciation or amortization method or the period of recovery or convention.
- A change from not claiming to claiming the additional first-year depreciation deduction (or vice versa).
- A change in the percentage of bonus depreciation.

- A change in salvage value to zero.
- A change in accounting for depreciable assets from a single to multiple asset account (or vice versa).
- A change to or from a recovery period that is specifically assigned by Code Section 168 (MACRS) or regulations or other published guidance.¹⁶

Also, a reallocation of basis from a depreciable asset to a nondepreciable asset, or vice versa, is a change in method of accounting, such as to correct the building/land allocation of depreciable real estate.¹⁷

CHANGES IN DEPRECIATION THAT DO NOT CONSTITUTE A CHANGE IN METHOD OF ACCOUNTING

Not all changes in depreciation or amortization are changes in method of accounting. The following are changes in depreciation that are *not* changes in method of accounting:

- A change in the useful life of an asset depreciated under Code Section 167.
- A change in the use of the asset.
- The making or revocation of an election, such as bonus depreciation (Code Section 168(k)) or expensing (Code Section 179).
- A change in the placed-in-service date.
- A change in underlying facts such as if the taxpayer changes the use of rental property from commercial (39-year recovery property) to residential (27.5-year recovery property).
- Where the taxpayer established a permissible method for depreciating property but forgot to deduct

depreciation using that method on one or more returns (this is a correction of an error that can only be remedied by filing an amended return for the year that the deductions were missed).¹⁸

Also, if the depreciation error results from an incorrect calculation of the basis of replacement property received in a Code Section 1031 like-kind exchange that is not related to treating the property from depreciable to nondepreciable or vice versa, this is not a change in method of accounting. This is a correction of an error that can only be remedied by filing an amended return.¹⁹

HOW TO MAKE A CHANGE IN DEPRECIATION AS A CHANGE IN METHOD OF ACCOUNTING

The rules. A taxpayer who uses an impermissible method of accounting for depreciation (for example, where depreciable property was treated as nondepreciable) for two or more consecutive years must use Form 3115 to make the change. Amended returns may not be filed for the two years even if the statute of limitations for filing amended returns has not expired for those years.²⁰

If the incorrect depreciation was claimed for only one year, then to make the change, the taxpayer has a choice of either filing an amended return for that one year or filing Form 3115 with the current year's timely-filed return.²¹

To claim depreciation that was missed on previous returns ("catch-up" depreciation), Form 3115 must be filed with a timely-filed return. The Designated Change Number ("DCN") is 7. DCN 7 is also used to make an adjustment if too

Exhibit 1: Rental Properties – Missed Depreciation						
Asset Description	Date Acquired	Cost Basis	Method	Recovery Period	Annual Missed Depreciation	Total Missed Depreciation
Property #1 - Building	01/01/2015	\$275,000	S/L	27.5	\$10,000	\$100,000
Property #1 - Land	01/01/2015	\$125,000	-	-	-	-
Property #2 - Building	01/01/2015	\$137,500	S/L	27.5	\$5,000	\$50,000
Property #2 - Land	01/01/2015	\$62,500	-	-	-	-
Property #3 - Building	01/01/2015	\$275,000	S/L	27.5	\$10,000	\$100,000
Property #3 - Land	01/01/2015	\$275,000	-	-	-	-
Totals		\$1,150,000			\$25,000	\$250,000

Exhibit 2: Information for Form 3115

Form 3115, Schedule E										Form 3115, Part IV			
Line 4(a)			Line 7(b)	Line 7(d)		Line 7(e)		Line 7(f)			Line 26		
Property Description	Date Placed in Service	Treatment Under Proposed Method	Rev. Proc. 87-56 Asset Class	Depreciation Method As Filed	Depr. Method Under Proposed	Recovery Period As Filed (Years)	Recovery Period Under Proposed Method (Years)	Applicable Convention As Filed	Applicable Convention Under Proposed Method	Cost Basis	Accum. Deprec. Through 12/31/2024 As Filed	Accum. Deprec. Through 12/31/2024 Under Proposed Method	Positive (Negative) IRC §481(a) Adjustment
Adjustments to correct depreciation for assets previously classified as nondepreciable (DCN 7):													
Sch. E - Property #1													
Building	01/01/15	Capitalize	00.3	N/A	S/L	N/A	275	N/A	MM	275,000	0	100,000	(100,000)
Land	01/01/15	Non-deprec.								125,000	0	0	0
Sch. E - Property #2													
Building	01/01/15	Capitalize	00.3	N/A	S/L	N/A	275	N/A	MM	137,500	0	50,000	(50,000)
Land	01/01/15	Non-deprec.								62,500	0	0	0
Sch. E - Property #3													
Building	01/01/15	Capitalize	00.3	N/A	S/L	N/A	275	N/A	MM	275,000	0	100,000	(100,000)
Land	01/01/15	Non-deprec.								275,000	0	0	0
Total Adjustment to Taxable Income										1,150,000	0	250,000	(250,000)

much depreciation was claimed on prior years' returns.

If the taxpayer has disposed of the property, then for the year of disposition, the taxpayer may claim the "catch-up" depreciation by filing Form 3115 with either the original or an amended return for the year of disposition. The DCN is 107. The five-year eligibility rule does not apply to DCN 107.²² DCN 107 may not be used to make an adjustment if too much depreciation was claimed on prior years' returns. In such a case, the taxpayer must use DCN 7.

"Catch-up" depreciation also includes changing from a permissible method of accounting for depreciation to another permissible method of accounting for depreciation. An example of this is additional depreciation that results from a cost segregation study where portions of the property are reclassified to personal property and land improvements that have shorter recovery periods under the Modified Accelerated Cost Recovery System (MACRS). In such a case, Form 3115 must be included with a timely-filed return. The DCN is 200.

"Catch-up" depreciation results in a negative adjustment (a decrease in taxable income) under Code Section 481(a).

Such a negative adjustment is taken into account in full in the year of change.²³ The adjustment that results from deducting too much depreciation in previous years is a positive adjustment (an increase in taxable income) under Code Section 481(a). A positive adjustment is taken into account ratably over four years (the year of the change and the following three taxable years, 25% each year).²⁴ For a positive adjustment, if the taxpayer ceases to be engaged in the trade or business, then the four-year period is accelerated and the remaining adjustment must be taken into account in the year of cessation.

If the "catch-up" depreciation results in a negative Code Section 481(a) adjustment (additional deduction), and if the activity is a passive activity in the current year, then the negative adjustment is subject to the passive loss limitations.²⁵ If the change results in a positive Code Section 481(a) adjustment (additional income), and if the activity is a passive activity in the current year, then the positive adjustment is treated as passive income.²⁶

Example. Let us take the situation described earlier regarding the new client. She has been preparing her own returns for the past 10 years, during which time she has never claimed

any depreciation for her three residential rental properties. In essence, she has treated her three residential rental properties as nondepreciable. Making a change to depreciate the building portion of each rental property is a reallocation of basis from nondepreciable to depreciable, which constitutes a change in method of accounting.²⁷

Exhibit 1 shows the details for the three rental properties and the amount of missed depreciation for the past 10 years:

To claim the missed depreciation on the 2025 return, the IRS says that the taxpayer must attach Form 3115 to the taxpayer's timely-filed return and attach a statement that includes the following items:

- A detailed description of the present and proposed depreciation.
- A description of the taxpayer's business or income-producing activities and the item(s) of property used in each activity.
- The facts and law supporting the proposed method of depreciation.
- The year in which the taxpayer placed in service the item of property.

The statement must include additional details if the property is public

utility property, if the property is used in a retail motor fuels outlet, or if the taxpayer is changing the classification from Section 1250 property to Section 1245 property.²⁸

If the taxpayer is a “qualified small taxpayer” — a taxpayer whose average annual gross receipts for the three preceding taxable years is less than or equal to \$10,000,000 — then there is a reduced filing requirement for Form 3115.²⁹ The taxpayer needs to complete only the following information on Form 3115:

- The identification section of page 1 above Part I.
- The signature section at the bottom of page 1.
- Part I.
- All lines of Part II except lines 13, 15b, 16c, 17, and 19.
- All lines of Part IV except line 25.
- Schedule E.

In the instant case, a spreadsheet such as the one shown as Exhibit 2 might be attached to Form 3115 to satisfy the answers to Part IV and Schedule E of Form 3115.

No later than the date that the return is filed, a copy of the signed Form 3115 and attached statement(s) should be sent to the IRS National Office, at the address or fax number shown in the Form 3115 instructions.

In this example, the negative Code Section 481(a) adjustment is \$250,000, which is an additional deduction reported on Schedule E of the 2025 return. This could result in an overall rental loss of more than \$25,000. If

the taxpayer is subject to the \$25,000 annual loss limitation on rental losses,³⁰ then this adjustment will carry forward as a passive loss.

CONCLUSION

A client who deducts the wrong amount of depreciation for a number of years can fix the error if it qualifies as a change in method of accounting. Most often, such errors in depreciation are due to reporting depreciable property as non-depreciable, or vice versa. Return preparers can fix the errors by learning how to make a change in method of accounting and how to complete Form 3115 for such errors.

End Notes

¹ Code Section 6511.

² Code Section 446(a); Treas. Reg. 1.446-1(a)(1).

³ Treas. Reg. 1.446-1(e)(2)(ii)(a).

⁴ Rev. Proc. 91-31, 1991-1 C.B. 566; Rev. Proc. 2002-9, 2002-3 I.R.B. 327, § 2.01(f).

⁵ Treas. Reg. 1.446-1(e)(2)(ii)(a).

⁶ See Rev. Rul. 90-38, 1990-1 C.B. 57.

⁷ Treas. Reg. 1.446-1(e)(2)(i).

⁸ <https://www.irs.gov/pub/irs-pdf/f3115.pdf>.

⁹ Most recent is Rev. Proc. 2025-23, 2025-24 I.R.B. 1476.

¹⁰ *Id.*, § 5.01(f).

¹¹ Rev. Proc. 2015-13, 2015-5 I.R.B. 419, § 6.03(f)(c).

¹² *Id.*, § 6.03(2)(c). See also Rev. Proc. 2026-1, 2026-1 I.R.B. 1, Appendix A, which states that the user fee is \$13,225 for such requests received after 1/29/2026, \$9,775 if the taxpayer’s gross income is below \$10,000,000, \$3,450 if the taxpayer’s gross income is below \$400,000.

¹³ Treas. Reg. 1.446-1(e)(2)(ii)(b). See also *Huffman*, 126 T.C. 322, 343-345 (2006), *aff’d*, 518 F.3d 357

(6th Cir. 2008) (accountant’s computational error in calculating LIFO ending inventory); *Wayne Bolt & Nut Co.*, 93 T.C. 500, 501-511 (1989) (items omitted from inventory discovered by taking a physical inventory was a posting error); *ESCO Corporation*, 750 F.2d 1466, 1470 (9th Cir. 1985), *rev’g and rem’g* 578 F.Supp. 738 (D. Or. 1983) (accruing workers compensation claims for the first time was correction of an error).

¹⁴ See Letter Ruling 200728001, quoting *Thompson-King-Tate, Inc.*, 296 F.2d 290 (6th Cir. 1961). See also Technical Advice Memorandum 200043010 and the cases discussed therein.

¹⁵ Treas. Reg. 1.446-1(e)(2)(ii)(d).

¹⁶ Treas. Reg. 1.446-1(e)(2)(ii)(d)(3)(i).

¹⁷ Chief Counsel Notice CC-2004-007; Field Service Advice 200048012; *Pinkston*, TCM 2020-44 (change in allocation of land of two Hawaii properties).

¹⁸ Treas. Regs. 1.446-1(e)(2)(ii)(b) and (d); Treas. Reg. 1.446-1(e)(2)(ii)(d)(3)(iii). See also Rev. Proc. 2025-23, 2025-24 I.R.B. 1476, § 6.01(f)(c)(vi) and (xii).

¹⁹ See *Thompson-King-Tate, Inc.*, 296 F.2d 290 (6th Cir. 1961).

²⁰ See Rev. Rul. 90-38, 1990-1 C.B. 57.

²¹ Rev. Proc. 2025-23, 2025-24 I.R.B. 1476, § 6.01(f)(b).

²² *Id.*, § 6.07(5).

²³ Rev. Proc. 2015-13, 2015-5 I.R.B. 419, § 7.03(f).

²⁴ *Id.*, § 7.03(4)(a).

²⁵ Temp. Reg. 1.469-2T(d)(7).

²⁶ Temp. Reg. 1.469-2T(c)(5).

²⁷ See footnote 17.

²⁸ Rev. Proc. 2025-23, 2025-24 I.R.B. 1476, § 6.01(3)(b).

²⁹ *Id.*, § 6.01(4).

³⁰ See Code Section 469(i).