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A closer look at the IRS's final tangible property regulations

The new rules attempt to clarify what must be capitalized under Sec. 263(a).

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On Sept. 13, 2013, the IRS released final regulations providing guidance on the deduction and capitalization of expenditures in acquiring, producing, and maintaining or repairing tangible property ([T.D. 9636](#)). The new rules, commonly called the repair regulations, replace previously issued temporary regulations and attempt to clarify Sec. 263(a), which requires the capitalization of the amount paid to acquire, produce, or improve tangible property; and Sec. 162(a), which allows deduction of ordinary and business expenses.

The final regulations are generally effective for tax years beginning on or after Jan. 1, 2014. Taxpayers may generally apply the provisions to tax years beginning on or after Jan. 1, 2012, although some of the provisions can only be applied to expenses paid or incurred in tax years beginning on or after Jan. 1, 2014. Following are a few highlights of the repair regulations.

General capitalization

As a general rule, all costs that facilitate the acquisition or production of real or personal property must be capitalized except for employee compensation and overhead costs.

Under final regulations, a taxpayer must capitalize amounts paid to acquire or produce a unit of property (UOP) unless the expense qualifies as a material or supply or the *de minimis* safe harbor election applies. This includes leasehold improvements, land and land improvements, buildings, machinery and equipment, and furniture and fixtures. The amounts paid to acquire or produce a unit of real or personal property include the invoice price and transaction costs.

Repairs and maintenance

In general, under the safe-harbor election for routine maintenance, a taxpayer may deduct amounts paid for repairs and maintenance to property other than a building or the structural components of a building if the activities occur more than once during the useful life of the unit of property and the amounts paid are not otherwise required to be capitalized, such as betterments, restorations, and adaptations to a new or different use.

The final regulations extend the concept of the routine maintenance safe harbor introduced by the 2011 temporary regulations to buildings. This includes the recurring activities that a taxpayer expects to perform as a result of its use of the building to keep the building structure or system in its ordinarily efficient operating condition. The taxpayer must reasonably expect to perform the activities more than once during a 10-year period beginning at the time the building structure or building system is placed in service.

Materials and supplies

The final regulations expand the definition of materials and supplies to include property that has an acquisition or production cost of \$200 or less, clarify application of the optional method of accounting for rotatable and temporary spare parts, and simplify the application of the *de minimis* safe harbor of Regs. Sec. 1.263(a)-1(f) to include materials and supplies.

De minimis safe harbor

An alternative to the general capitalization rule is the *de minimis* safe-harbor election, which allows businesses to elect to expense qualifying expenses such as amounts paid to acquire or produce any eligible unit of property or any eligible materials and supplies.

A taxpayer is eligible for the *de minimis* safe-harbor election if the taxpayer meets all three of the following:

- At the beginning of the year the taxpayer has written accounting procedures opting to expense for nontax purposes, such as book financials, amounts paid for property costing less than a specified dollar amount or acquisitions with an economic useful life of 12 months or less.
- The taxpayer treats the amount paid for the property as an expense on its applicable financial statements (AFSs) if it has AFSs or on its books and records if it does not.
- The taxpayer has an AFS and the amount paid for the property does not exceed \$5,000 per invoice. If the taxpayer does not have an AFS, the amount cannot exceed \$500.

It should be noted that the \$5,000/\$500 limit is a safe harbor rather than an absolute limit. It is not intended that IRS examining agents must revise the taxpayers' materiality thresholds in accordance with the *de minimis* safe-harbor limitations. Therefore, if examining agents and a taxpayer agree that certain amounts in excess of the *de minimis* safe-harbor limitations are not material or otherwise should not be subject to review, that agreement should be respected despite the requirements of the *de minimis* safe harbor. However, a taxpayer that tries to deduct amounts in excess of the amount allowed by the safe harbor has the burden of showing that such treatment clearly reflects income.

Property ineligible for *de minimis* safe harbor election includes:

- Property that is or is intended to be included in inventory;
- Land;
- Rotable, temporary, and standby emergency spare parts that the taxpayer elects to capitalize and depreciate; and
- Rotable and temporary spare parts that the taxpayer accounts for under the optional method of accounting for rotatable parts.

The *de minimis* safe-harbor election is made by attaching a statement to the taxpayer's timely filed federal tax return including extensions. The statement must be titled "Section 1.263(a)-1(f) *de minimis* safe harbor election" and include the taxpayer's name, address, taxpayer identification number (TIN), and a statement that the taxpayer is making the *de minimis* safe-harbor election.

Editor's note: This column provides a snapshot look at some aspects of the repair regulations. Topics not covered include:

- *Disposals of MACRS property;*
- *Costs to investigate and pursue the purchase of real property;*
- *Expenditures for property on which a casualty loss has been deducted;*
- *Costs subject to capitalization under Sec. 263A;*
- *Regulatory accounting methods; and*
- *Costs paid to facilitate the sale of property.*

More information on the regulations can be found in the AICPA [Tax Section's resource page](#) on the subject and in the [Journal of Accountancy](#).

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