

# *The Bankler Report*

December 19, 2013

## **INTRODUCTION**

In September, the US Treasury issued final “repair” regulations (T.D. 9636). These regulations are applicable to tax years beginning after 12/31/13 and discuss the “new rules” that must be applied in determining when an item is repair vs. a capital expenditure. They affect virtually any business with tangible assets. The IRS has estimated that about 4 million businesses must comply.

### **Background:**

At a length of over 200 pages, the regulations remain complex. Taxpayers and their advisors will need to devote significant time and effort to study these regulations and to address their impact on their tax accounting. They must decide whether they can deduct costs as repairs and maintenance or must capitalize the costs and recover their costs over a period of years. Every business, especially those with significant fixed assets, must develop an understanding of the regulations and their requirements. Moreover, they will have the option of applying the regulations (either the temporary or the final) to the 2012 or 2013 tax years.

### **Significant Provisions in Final Regulations:**

Materials and supplies - The threshold for deducting materials and supplies was increased from \$100 to \$200 and generally applies to items expected to be consumed in 12 months or less, or that have an economically useful life of 12 months or less.

Tangible Property - De minimis safe harbor - The final regulations eliminate a controversial ceiling on the use of this safe harbor to deduct property. Taxpayers with applicable financial statements (i.e., audited financial statements) can apply the safe harbor to an item that is \$5,000 or less. The regulations extend the safe harbor to taxpayers without a financial statement, but only for property that costs \$500 or less. Taxpayers must have written “book” (i.e., financial statements) policies in place at the beginning of the year to apply the safe harbor.

### **Unit of Property - Building and Non-Building:**

The final regulations retain the controversial concept of “unit of property” (UOP). A single UOP consists of all components that are functionally interdependent, such that one component can’t be placed in service without the other components (example: engine in a car). The rules for buildings differ, however, in that each building and its structural components are treated as one UOP. The regulations list nine specific building systems that are treated as separate from the building structure.

## **Routine Maintenance Safe Harbor:**

This safe harbor allows routine maintenance expenses to be deducted as incurred. Routine maintenance means recurring activities that keep business property in ordinarily efficient operating condition, such as inspection, cleaning, testing, and replacement of damaged or worn parts. For buildings, the recurring maintenance must occur more than once during a 10 year period, which many practitioners believe is too short a period.

Every taxpayer that owns property used in a business is going to be subject to these rules and, for many, there are documents that must be prepared before year end and elections to be made with the returns, making it imperative to understand these de minimis rules.