The IRS recently issued, after seven years of analysis, final regulations on the question of whether an expenditure relating to tangible property is a deductible repair or a capital expenditure. These new regulations change a number of previous tax rules and provide a number of new safe harbors and other rules that may benefit taxpayers.

Many of the new changes allow a taxpayer to follow for tax purposes the same policies that they follow for financial accounting ("book") purposes, provided these policies are written. ***For this reason one of the most important tasks for taxpayers will be to prepare a written statement of such policies. According to the IRS, this written statement must be in place by January 1, 2014, in order to take advantage of many of the provisions under the new regulations.***

Some of the most significant provisions in the final regulations are the following:

1. **Materials & Supplies** – Material & supplies are defined to include items which are expected to be consumed in 12 months or less, or which have an useful life of 12 months or less, and are used to maintain, repair or improve tangible property. The taxpayer can now make an election to deduct such items if the per item amount is $200 or less.

2. **De Minimis Safe Harbor for Repairs and Maintenance** – Taxpayers that have a written book policy in place and who also have certified audited financial statements prepared can deduct a repair item up to $5,000 per item or per invoice. Taxpayers who have a written book policy but do not have audited financial statements can deduct a repair item up to $500 per item or per invoice.

3. **Election to Capitalize De Minimis Safe Harbor Amounts for Repairs and Maintenance** – Taxpayers can elect to capitalize and depreciate amounts that would otherwise be subject to the De Minimis Safe Harbor rules.

4. **Improvements Defined** – In general, a taxpayer must capitalize amounts paid to improve a unit of property. The regulations define three types of expenditures that must be capitalized:
   A. A betterment
   B. A restoration
   C. An adaptation to a new or different use

5. **Routine Maintenance Safe Harbor** – Costs for the Routine Maintenance of property (including inspections, cleaning, testing, and replacement of parts) can

be deducted. *Although this practice has been used with tangible property in the past, this IRS regulation is formally acknowledging it and expands it to also include Routine Maintenance costs of real property*.

6. **Small Taxpayer Election to deduct $10,000 of building expenses** – A small taxpayer is one whose average annual gross receipts, measured for the prior three years, is less than $10 million. An eligible building is one with a tax basis, before depreciation, of $1 million or less. Assuming these two criteria are met, the business can deduct the smaller of $10,000 or 2 percent of the cost of the building annually. This election is accomplished by attaching a statement to a timely filed tax return.

In order to utilize some of these changes it may be necessary to file Form 3115, Change in Accounting Method, prior to the ending of the year.

Effective date

The final regulations generally apply to taxable years beginning on or after Jan. 1, 2014.

If you have any further questions regarding these new regulations, please contact us to discuss them further.

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