New IRS Tangible Repair Regulations

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Presenter Bios

Jay E. Wadsworth, Shareholder

Jay has been with PDR CPAs for over 17 years, focusing primarily on corporate and partnership tax compliance. His expertise includes: Mergers and Acquisitions, Tax Planning, Business Succession Planning, Estate & Trust taxation. Additionally, Wadsworth has extensive experience with R&D tax credits and has assisted many business owners in taking advantage of this as well as other tax credits.

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M. Javier Zuñiga, Senior Consultant

Javier's expertise includes corporate and partnership tax compliance, partnership structures, international taxation, individual taxation and forensic accounting. He is also part of PDR CPAs R&D tax credit and cost segregation studies practice areas.

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Agenda

1 The New Standards

2 De Minimus Rules

3 Implications Relating to Audited Financials Statements

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The New Standards

Summary of the Repair and Capitalization Rules

- Materials and Supplies - items acquired with a cost of up to $200 can be categorized as a material and supply and deducted under special rules.

De Minimis Rule

- The final regulations provide a “De Minimis” rule which avoids the need to capitalize certain costs where the taxpayer satisfies certain conditions.
- For those taxpayers with an Applicable Financial Statement (AFS), the taxpayer must:
- “have a written policy at the beginning of the tax year providing for the expensing of either items costing less than $5,000; or items which have a useful life of not more than twelve months, but limited to $5,000 for each item”
- For those taxpayers without an AFS, the taxpayer must:
- “have a policy at the beginning of the year to expense either items costing less than $500; or items which have a useful life of not more than twelve months, but limited to $500 for each item”

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The New Standards (continued)

<u>Costs to repair or Improve Tangible Property</u>

Prior to the repair regulations, case law established that these costs were deductible as repair costs if they were incidental in nature, did not materially add to the property's value, did not appreciably prolong the useful life and did not adapt the asset to new use.

The new regulations now implement a BAR standard (instead of the judicial tests outlined above):

- Costs will be capitalized if they produce either of these:
  - **Betterment to the property or**
  - **Adaptation to new use of the property or**
  - **Restoration of the property**

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Summary of Major Changes

- **De minimis Rule Change-** Amounts <$5,000 can be expensed for tax as long as they are expensed on applicable financial statements. Taxpayers without Applicable Financial Statements are limited to $500 per item.
- **Routine Maintenance Safe Harbor rule-** extend safe harbor to buildings but require 10 years as the period which a taxpayer must reasonably expect to perform the relevant activities more than once.
- **Relief for Small Businesses-** small taxpayers can forgo improvement rules on eligible buildings
- **Changes to definitions of Betterments and Restorations**
- **Dispositions**- Final Regulations (Issued August, 2014) change rules for partial dispositions of assets. Require making timely elections.

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De minimis Rule Expensing Safe Harbor §1.263 (a)-1(f)

- Taxpayer with an Applicable Financial Statement (AFS)
  - $5,000 expensing threshold per item or invoice for property
  - Must have written expensing policy stating such
  - Must treats amounts as expenses on the AFS as well
- Taxpayer without Applicable Financial Statements (AFS)
  - $500 expense threshold per item or invoice
  - Do not need written expensing policies
  - Can not split costs among multiple invoices
  - If elected, must apply to all eligible materials & supplies except, rotable, temporary and standby emergency spare parts.

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Implications Relating to Audited Financials Statements

<u>Safe Harbor for Small Taxpayers</u>

- Can elect to expense amounts < or = $10,000 or 2 percent of unadjusted basis of the building, if
- Small taxpayer: <$10M in average annual receipts over last 3 years
- Eligible building= unadjusted basis of $1 million or less
- If amount > $10,000, safe harbor does not apply to any amounts (not even the first $10,000). Includes expenses under *de minimis* and routine maintenance safe harbor
- Elected annually on building-by-building basis

- Tax Planning Idea: Cost Seg Study may reduce real property basis enough to make you eligible for this election.
  - Ex. Before Cost Seg 39 year building basis is $1.3M
  - After Cost Seg 39 year basis is $900K and rest reclassified to 5 & 15 year

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Q&A

Jay Wadsworth and M. Javier Zuniga

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