2014 Changes to Capitalization of Tangible Property Costs Will Impact Many Taxpayers

During 2014, final rules and regulations became effective for handling the acquisition, repair, improvement and disposition of real estate and tangible personal property. Many types of expenditures are covered in the final regulations, and they will likely affect all taxpayers that acquire, produce or improve tangible property. The rules will necessitate a review of current accounting practices and policies, potential adjustments of tax methods used to account for acquisitions and dispositions, and possible tax compliance changes involving tax elections and changes in accounting methods. Although many of the changes are specifically applicable to real estate and manufacturing businesses that use real property and tangible property as business assets, these rules may apply to other businesses as well.

Here are the major highlights:

**Acquisition of Tangible Property**

- **De Minimis Rule:** A taxpayer may have a written policy that elects a de minimis safe harbor for deducting purchases of or tangible property under a specified amount. If the de minimis amount is $5,000 for book purposes, then the taxpayer may deduct items that do not exceed $5,000 per invoice (or per item based on the invoice). Amounts greater than $5,000 will not qualify but may be deductible if the facts indicate the larger amounts are immaterial or will clearly reflect income.
- **Materials and Supplies:** A taxpayer may deduct items with an acquisition or production cost up to $200. The rules provide specific elections for rotatable, temporary and emergency spare parts.
- **Routine Maintenance:** A taxpayer with recurring costs required to keep property in its ordinarily efficient operating condition and not improve the property may qualify for deduction as routine maintenance. An expenditure, regardless of size would be considered routine maintenance if activities and costs are expected to be incurred more than once during the asset class life.
- **Major Components and Structural Parts:** A taxpayer must identify each unit of property and apply the capitalization rules. While a building is generally considered a relevant unit of property, the rules are applied to each building structure or system that has a discrete and critical function.
- **Repairs and Improvements:** A cost for repairs or improvements of units of property is generally capitalized when the cost results in betterment,
restoration or adaption of units of property to a new or different use. They are deductible if consistent with the intended, ordinary use of property.

Disposition of Tangible Property

- **Substitution of Costs:** An acquisition of property may result in a disposition if it is permanently withdrawn from use, including sale, exchange, retirement, abandonment, transfer or destruction. The acquisition is capitalized and loss is claimed on any undepreciated cost of original property.

- **Partial Disposition Rules:** A loss deduction may be elected on a partial disposal of a portion of structural components. A simplified method is used to determine adjusted basis for disposition.

The new law contains many potential accounting and tax compliance changes that will need to be addressed during the preparation of the 2014 financial statements and tax returns. The impact may include changes in accounting policies, accounting methods, and additional tax elections in order to comply with the new rules prospectively.