New IRS Tangible Property Regulations

The top four things to know.

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BY NOW, YOU HAVE LIKELY HEARD about the new IRS **tangible property regulations**. These regulations were issued to provide guidance on when companies should capitalize or expense improvements and purchases. Manufacturers, who are likely to benefit from these new rules, will see significant impact. Action on your 2014 tax return may be required.

The rules, which affect every taxpayer using tangible property in its business, are complex and their impact is widespread. Here are the top four things you should know:

1. DE MINIMIS RULE

Under the de minimis rule, the IRS allows businesses to elect to expense items under a certain dollar threshold: $5,000 for taxpayers with applicable financial statements, $500 for all other taxpayers. You need to have a capitalization policy to take advantage of this election. This policy should note that you treat as an expense:

- Amounts paid for property costing less than a specified dollar amount, or
- Amounts paid for property with an economic useful life of 12 months or less.

2. MATERIALS AND SUPPLIES

This area is important to manufacturers, who usually have substantial amounts of materials and supplies. Manufacturers should know how they currently treat materials and supplies. Are you using the incidental method to write off items when purchased or do you use the non-incidental method, writing off items when they are placed in service? Do you have rotable or emergency spare parts?

3. LATE PARTIAL DISPOSITIONS

Under the new rules, taxpayers can write off retired, replaced or abandoned building components. In addition, the IRS is giving taxpayers a small window, the 2014 tax year, to write off any replaced items that were incurred in previous tax years.

For example, assume you purchased a building in 1995 and replaced the roof in 2005 and capitalized the cost. Under the old rules, you would be simultaneously depreciating two roofs. Under the new rules, you are allowed to write off in 2014 the remaining tax basis of the 1995 roof that was replaced.

Going forward, you can write off the remaining tax basis of disposed building components in the year they are disposed.

In addition, starting in 2014, taxpayers can write off removal costs related to dispositions rather than capitalizing these costs as part of the new asset. This is a great benefit to those who have their contractor separately break out the demolition and removal costs from the new construction costs.

4. THE CAPITALIZATION TESTS AND UNIT OF PROPERTY

In the past, taxpayers capitalized expenditures if they increased the value or prolonged the useful life of the property. The new standards look at betterment, restoration or adaptation of the unit of property (UOP) to determine what gets capitalized. The amount you spend is no longer a determining factor.

Understanding and defining your UOP is imperative in applying the new rules. The larger the UOP, the more opportunities you will have to deduct expenses as repairs. Generally, components that are functionally interdependent make up a UOP. However, for plant property, you have to break that down further into smaller units of components that perform a discrete and major function or operation.

You may have previously capitalized items that, under the new regulations, would be considered repairs and maintenance. Taxpayers are allowed to write off these previously capitalized items by filing a change in accounting method, which in many cases will reduce taxable income.

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These new rules are complex and there is no easy, one-size-fits-all way to analyze the rules and apply them to taxpayers. Talk with your CPA to see how these rules will affect you specifically — not only historically, but on a go-forward basis.

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