What you need to know

Tangible Property Regulations

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Tangible Property Regulations

In September of 2013, the IRS issued the final tangible property regulations which took effect on tax years beginning after January 1, 2014. These rules apply to anyone who uses tangible property in their business, and determines what can be deducted versus what must be capitalized. Those entities or individuals who incur larger capital expenditures are affected most by the regulations. All businesses (including non-profits) subject to U.S. tax law are equally impacted, regardless of industry, organization size, or type of legal entity.

Many distinctions are made in the new regulations regarding tangible property including dispositions, fixed assets versus materials and supplies, capital improvements versus deductible repairs, costs to acquire or produce tangible property, and what defines a unit of property.

FAST FACTS

- Safe Harbor elections allow for expensing of otherwise capitalized costs in select cases.
- Improvement expenditures must be capitalized if the asset is "bettered."
- Repairs and maintenance, as a regular course of business, are deductible and are not capitalized.
- All acquisition costs associated with tangible property used in a business must be accounted for under the IRS's final regulations.

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Dispositions

Dispositions are the transfer of ownership or the permanent withdrawal of an asset from use in a trade or business. These entail the sale or exchange of an asset, as well as physical abandonment, retirement, destruction, transferring items to a supplies account, and the retirement of a structural component of a building. The major distinction for dispositions under the new regulations is whether a gain or loss is recognized based on the type of disposals. If the asset is sold, exchanged, or converted involuntarily, a gain or loss must be recognized. If the asset is disposed in any other manner, a gain is not recognized. If a general asset account is used, partial dispositions are not allowed under the new regulations.

Materials and Supplies

If tangible property qualifies as materials or supplies, a more favorable tax deduction may result for the taxpayer when the item is used or consumed. The definition of materials and supplies is a unit of property costing $200 or less or having an economic useful life of 12 months or less.

Costs Paid to Acquire & Produce Tangible Property

Any amount paid or incurred to acquire or produce tangible property must be capitalized according to the new regulations. Transaction costs such as transporting property, appraisal costs, bidding costs, and obtaining regulatory approval in the form of permits also must be capitalized. All acquisition costs associated with tangible property used in a business must be accounted for under the IRS's final regulations. The final regulations require taxpayers to capitalize amounts to acquire, produce, or improve tangible property.

FYI

Be sure to talk with Reilly, Penner & Benton to learn what the most current rules, regulations and changes may apply to you when working with tangible property regulations.

Improvements

Expenditures must be capitalized if the asset is "bettered." This can be correcting material defects, an addition or expansion, or materially increasing quality, productivity and/or efficiency. Adaptations to change the use of the property must also be capitalized. In general, a taxpayer does not capitalize costs incurred to remove a component. Repairs and maintenance, as a regular course of business, are deductible and are not capitalized. The IRS allows for a de minimis safe-harbor exception to the capitalization rule. This election can be made at a max threshold of $5,000 if the taxpayer has an Applicable Financial Statement ($2,500 without an AFS) to expense items which would otherwise be capitalized.

Unit of Property

Whether or not tangible property expenditures require capitalization is affected by what is defined as the unit of property. A unit of property generally includes "functionally interdependent" components of the property. The unit of property in question determines which rules will be followed according to the final regulations.

A Note to the Reader

A de minimis safe harbor note: You can still deduct maintenance and repairs costs that are above the safe harbor threshold of $5,000 (or whichever threshold your entity uses). General rules apply for deducting supplies, materials, and repair and maintenance costs that exceed the threshold.