

ANDERS REAL ESTATE AND CONSTRUCTION REPAIR REGULATIONS

The IRS released regulations that clarify rules related to the acquisition, production, or improvement of tangible property, known as repair regulations. Before the regulations were passed in 2013, there was little or no guidance from the IRS on this topic. Generally applicable to tax years beginning on or after January 1, 2014, the regulations are meant to help companies determine which expenditures should be deducted as repair and maintenance expenses, and which must be capitalized.

WHO IS IMPACTED?

Every taxpayer that uses tangible property in their business is impacted by these regulations. Considering most businesses use tangible property, these changes impact nearly all businesses.

WHAT CAN ANDERS DO FOR YOU?

One of the most important things we can do is get you ready for year-end tax filings, which will be more cumbersome than in the past. With the numerous new elections and change of accounting methods, there will be a lot of requirements to file a complete and accurate tax return.

Additionally, we can review your fixed asset schedule to determine what corrections or adjustments need to be made going forward. There are many changes to the way fixed assets and repairs should be reported. It is a good idea to review before year-end to ensure proper reporting and classification.

KEY ISSUES TO LOOK OUT FOR

1) DE MINIMIS SAFE HARBOR

As long as certain requirements are met, this election allows taxpayers a safe harbor for expenditures under \$5,000 when the taxpayer has applicable, audited financial statements, and \$2,500 when the taxpayer does not have applicable financial statements. It requires the taxpayer to have a capitalization policy in place at the beginning of the year.

2) SAFE HARBOR FOR SMALL TAXPAYERS

Allows some small businesses to expense a certain amount of repairs without additional records, relieving administrative burden for the smallest of taxpayers. To qualify, the taxpayer must have average annual gross receipts of \$10 million or less over the prior three tax years, and buildings with unadjusted basis of \$1 million or less.

3) PARTIAL ASSET DISPOSITION

Allows a taxpayer to recognize a gain or loss upon the disposition of a structural component, or portion thereof, of a building or upon the disposition of a component, or portion thereof, of any other asset.

4) ELECTION TO CAPITALIZE REPAIR AND MAINTENANCE COSTS

5) ELECTION TO CAPITALIZE EMPLOYEE COMPENSATION COSTS OR OVERHEAD

6) ELECTION TO CAPITALIZE CERTAIN MATERIALS AND SUPPLIES

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OTHER KEY ISSUES TO ADDRESS:

- **ROUTINE MAINTENANCE**

This change allows taxpayers to deduct the cost of recurring maintenance on personal and real property to maintain efficient operating condition. Examples include inspection, cleaning, testing and replacement of parts. The taxpayer must reasonably expect to perform those maintenance activities more than once during the depreciable class life of the personal property, or more than once during a ten year period for buildings.

- **REMOVAL COSTS**

If the taxpayer realizes a gain or loss on disposition, these are not capitalized as an improvement. If no gain or loss is realized, the taxpayer must capitalize the improvement costs.

- **DEFINITION OF MATERIALS AND SUPPLIES**

The regulations have changed the definition of what qualifies as a material and a supply, which impacts many industries.

- **UNDERSTANDING THE DEFINITION OF UNIT OF PROPERTY**

WHAT IS CONSIDERED A UNIT OF PROPERTY (UOP)?

A common dilemma for taxpayers has been determining when an asset is improved versus maintained or repaired. It is crucial to understand what makes up a unit of property and how functional interdependence is factored.

The following examples are considered separate building systems under the UOP rules:

- HVAC
- PLUMBING
- ELECTRICAL
- ESCALATORS
- ELEVATORS
- FIRE PROTECTION AND ALARM
- SECURITY
- GAS DISTRIBUTION
- "ANY OTHER SYSTEM IDENTIFIED IN PUBLISHED GUIDANCE"

An expenditure is considered an improvement to a UOP and required to be capitalized if it results in one of three outcomes to any one functionally interdependent component:

- **Results in a betterment or permanent improvement to the UOP**
- **Restores the UOP to its value or use**
- **Adapts the UOP to a new or different use**

HOW TO IMPLEMENT THE REPAIR REGULATIONS

The various changes require different methods of implementations. Some of the changes can be implemented simply by following the new method, but most will need either an election statement or a change of accounting method to be attached to your tax return. Following the right procedure to implement the change will be extremely important going forward.

