

BDO KNOWS:

FIXED ASSETS



► SUBJECT

HIGHLIGHTS OF THE TANGIBLE PROPERTY REGULATIONS

► SUMMARY

The new tangible property regulations are comprehensive and will affect virtually all taxpayers. The regulations contain guidance for determining whether and when a business must capitalize costs incurred in acquiring, maintaining, or improving any tangible property. The regulations are temporary, but have the same binding effect as final regulations.

EFFECTIVE DATE

- Regulations are generally effective for taxable years beginning on or after January 1, 2012.
- Two revenue procedures will be issued in the near future with transition rules.

DE MINIMIS DEDUCTION RULE

- Created a bright-line *de minimis* rule to deduct amounts up to a ceiling.
- Required to have applicable financial statement (“AFS”), written capitalization policy, and expense in AFS according to written policy.
- Deduction is limited to the greater of 0.1% of tax gross receipts or 2% of depreciation on AFS.

MATERIALS AND SUPPLIES

- Regulations modify and expand the definition of “materials and supplies.”
- Amounts are generally deductible when used.
- Set out an optional method of accounting for rotatable temporary spare parts.
- Provide an election to treat certain materials and supplies as currently deductible under the *de minimis* rule.

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UNIT OF PROPERTY (“UOP”)

- Regulations define a UOP for real and personal property.
- UOP is the reference point upon which the improvement standards are applied.
- Other than buildings, the UOP is all components of the property that are “functionally interdependent.”
- Regulations define the UOP for a building as the building and its structural components. However, the improvement standards must be applied separately to the major components of the building which consist of the following: HVAC; plumbing; electrical; escalators; elevators; fire protection; security; and gas distribution. The building structure is defined as the building and its structural components, other than the specifically defined building systems.
- No UOP is defined for network assets (*e.g.*, railroad tracks, pipelines, cable lines). The Service will issue industry issue resolutions for specific industries.

CAPITALIZATION STANDARDS

- Capitalization standards must be applied to the UOP. The regulations preclude the taxpayer from deducting the cost of the item if the amount paid to improve a UOP:
 - Results in a “betterment;”
 - “Adapts” the UOP to a new and different use; or
 - Results in a “restoration.”
- The determination of an improvement is fact specific. Many examples are provided in the regulations.

ROUTINE MAINTENANCE SAFE HARBOR

- Regulations retain the safe harbor for routine maintenance from the 2008 proposed regulations.
- Amounts can generally be deducted if they are for recurring activities a taxpayer expects to perform as a result of the taxpayer’s use of the UOP to keep the UOP in its ordinarily efficient operating condition.
- Safe harbor does not apply to buildings.

DISPOSITIONS

- Regulations expand the definition of the disposition of property to allow the retirement of components of a UOP, including structural components of buildings.
- New rule mitigates capitalization of duplicative improvements to a UOP, for example capitalization of multiple roof replacements.
- No guidance was provided on how to determine the basis of disposed components.

WHAT SHOULD YOU BE DOING?

- For previously filed “repair” accounting method changes, assess compliance with the new rules.
- Determine how the new definitions of materials and supplies, UOP, improvements, dispositions, and routine maintenance affect how you capitalize or deduct expenditures.
- Review how the bright-line *de minimis* rule affects your company.
- Evaluate how the new provision for dispositions will affect your retirements - consider cost segregation studies to identify replaced components eligible for write-off.
- Evaluate compliance with the regulations and assess the risks.
- Consider a fixed asset study to accelerate deductions to increase cash flow and manage compliance with these regulations.

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