What is Tangible Property?

• Physical Property

• **Depreciable** Tangible Property
  • Expense over time

• Repairs
  • Expense when occur

• Improvements
  • Expense over time
What You Need To Know

• Things have changed

• New definitions

• Benefits!

• Knowledge is Power
The Boring Stuff - History

• Tangible Property Regulations
  • 2003: IRS Notice 2004-6
  • 2011: Temporary Regulations
  • 2013: Final Regulations (T.D. 9636)
  • 2014: Additional Guidance (T.D. 9689)
The Final Regulations

• Applicable January 1, 2014

• Affect all taxpayers with tangible property

• Largest piece of tax legislation in decades.

• Simplify tangible property procedures

• Reg §1.263(a)-3
Why do we care?

• Compliance
  • We all want to follow the rules

• Tax Savings
  • “A nickel ain’t worth a dime anymore.”

• Capital Gains
  • No depreciation, no depreciation recapture!
The Old Ways...

• Repairs and Maintenance

  • “Expenses incurred for the purpose of keeping property in an ordinarily efficient operating condition over its probable useful life for the uses for which the property was acquired.”
And now...

- Repairs and Maintenance
  - “Amounts paid for repairs and maintenance to tangible property are deductible if the amounts paid are not required to be capitalized under §1.263(a)-3”
The Old Ways...

• Improvements

• “Replacements, alterations, improvements, or additions that appreciably prolong the life of the property, materially increase its value, or make it adaptable to a different use.”
And now...

• Improvements

  • “A taxpayer generally must capitalize the related amounts paid to **improve a unit of property** owned by the taxpayer.”
Improvements

• A **Unit of Property** is improved if the amounts paid for activities performed after the property is placed in service:
  
  • Are for a **Betterment** to the Unit of Property
  
  • **Restore** the Unit of Property
  
  • **Adapt** the Unit of Property to a new or different use.
New Questions

1. What is the “Unit of Property”?  
2. Is it a Betterment?  
3. Is it a Restoration?  
4. Is it an Adaptation?  

• What do these mean?!
The Building Block – The Unit of Property

• “All components (real or personal property) that are functionally interdependent to one another.”

• Functionally interdependent
  • Can not place one in service without the other
  • Can not function alone

• Facts and Circumstances
Separate Units of Property

Unit of Property #1

Unit of Property #2
Single Unit of Property

All Components: One Unit of Property
Unit of Property - Building

1. Building and its structural components

2. Building Systems
   • HVAC
   • Plumbing
   • Electrical
   • Escalators
   • Elevators
   • Fire Protection & Alarms
   • Security Systems
   • Gas Distribution
Unit of Property: HVAC System
Unit of Property - Leasehold

• Landlord
  • Entire building and its structural components
  • Building systems

• Tenant
  • Portion of the building subject to lease
  • Structural systems associated with the leased portion
Betterment

1. Corrects a material preexisting condition or defect
   • Exist *prior to* acquisition or production of the UOP
   • *Material* in amount or nature
   • Facts and Circumstances!
Also a Betterment

2. Is for a material addition
   • Enlargement
   • Expansion
   • Extension
   • Addition of major component
   • Increase capacity
Absolutely a Betterment

3. Increases the productivity, efficiency, strength, quality, or output of the unit of property.
Not a Betterment

• Normal wear and tear

• Damage

• Unavailability of replacement parts
Repairs and Improvements
Tangible Property Regulations

NOT a Betterment!
Restorations

• Returns the UOP to its ordinarily efficient operating condition.
  • State of disrepair
  • No longer functional

• Rebuilding of the UOP to a like-new condition
  • After end of class life
Repairs and Improvements

Tangible Property Regulations
More Restorations

- Replacement of a part or combination of parts
  - Major component
  - Substantial structural part
- Replacement of a component
  - Deduct a loss
  - Gain or loss on sale or exchange
- Casualty Loss
Major Component
Discrete Function
Restoration
Adaptations

- Adapt a unit of property to a new or different use.
  - Not consistent with ordinary use at the time it was originally placed in service.

- Buildings
  - Must adapt the structure or building systems
  - Unit of Property
Special Rules for Improvements

• Indirect Costs
  • Repair: Expense
  • Improvement: Capitalize

• Removal Costs
  • Repair: Expense
  • Improvement: Capitalize
Capitalize if Improvement!
Relief!

• Safe Harbor for Routine Maintenance
• De Minimis Safe Harbor
• Safe Harbor for Small Taxpayers
Safe Harbor for Routine Maintenance

• Activities performed to keep property in its ordinary efficient operating condition.
• Inspection, cleaning, testing, replacement of parts, other recurring activities
• Occurs more than once during the asset’s class life
• Buildings – occurs more than once in a 10 year period.
Expected Life: 5 years, 6,000 hours

Paint: 3,000 hours
Tires: 1,200 hours
Hydraulic System: 3,000 hours
Transmission: 3,000 hours

Routine Maintenance!
De Minimis Safe Harbor

• Deduction of *any* tangible property

• Applicable Financial Statement (AFS)
  • Audited
  • Required by SEC
  • Required by Government Agency (not IRS)
De Minimis Safe Harbor

- AFS
  - $5,000 Safe Harbor
- No AFS
  - $500 Safe Harbor
- Consistent Company Policy
- Annual Election
Safe Harbor for Small Taxpayers

• Small Taxpayer
  • $10,000,000 average gross receipts for the preceding 3 years

• Eligible Building Property
  • $1 million unadjusted basis

• Costs may not exceed, in aggregate, the lessor of:
  • $10,000
  • 2% of the property’s unadjusted basis
Unadjusted Basis

• $750,000

Repairs & Improvements

• $10,000

Safe Harbor!!!

Repairs & Improvements

• $10,500

I-BAR
Necessary Steps

1. Does it qualify for relief?
   a. Under your safe harbor threshold?
   b. Routine in nature?
      ✓ Yes? **STOP!** Expense it!

2. Determine your Unit of Property.
   a. Functionally interdependent
Necessary Steps (Continued)

3. Is it an Improvement?
   a. Betterment
      • Pre-existing condition
      • Material addition
      • Increase productivity, efficiency, etc.
   b. Restoration
      • Like-new condition
   c. Adaptation to new use

✓ No? Expense it!
Final Thoughts

• What about GAAP?!
  • Expense for Tax, Capitalize for GAAP
  • Does not apply to the De Minimis Safe Harbor

• This is a good thing!
  • Tax friendly
Thank You!