



The final tangible asset and repair regulations – Part II

Clarifications and taxpayer-friendly safe harbors and elections added for acquisition and improvement rules

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In September 2013, the Treasury Department and the IRS (hereinafter called the government), released the much-anticipated final (and proposed) tangible asset and repair regulations (the final regulations). The majority of the regulations were issued in final form.¹ However, as expected, regulations surrounding dispositions of tangible property were issued in proposed form, but also as reliance guidance. The government has not yet released updated transitional guidance (superseding [Rev. Procs. 2012-19](#) and [2012-20](#), which provide the automatic method change procedures for taxpayers to early adopt provisions of the temporary regulations). It is expected that such guidance will be issued in early November of this year.

¹ See [TD 9636](#).

The [first article](#) in this four-part series on the final and proposed regulations analyzed the favorable changes to materials and supplies and de minimis safe harbors. This second article focuses on the clarifications and additions made to the acquisition and improvement rules. The third article in this series will address changes and additions with respect to the improvement standards for betterments, restorations and adaptations to a new or different use, and the fourth article will discuss the new proposed regulations governing dispositions and general asset accounts (GAAs).

While the acquisition rules are substantially the same, changes were made to clarify certain provisions. The improvement rules not only include additional provisions intended to clarify application of the improvement standards, but also provide taxpayer-favorable safe harbors, elections and other modifications intended to simplify and add flexibility in their application. These modifications, clarifications and additions are discussed in depth below. Changes and additions to the improvement rules discussed herein include:

1. Clarification of the unit of property determination for leasehold improvements
2. Clarification of the treatment of removal costs
3. Addition of a small taxpayer safe harbor that, if applicable, provides qualifying taxpayers with the option of refraining from applying the improvement rules to eligible building property
4. Expansion of the routine maintenance safe harbor to include costs incurred with respect to building property
5. Election to capitalize certain repair and maintenance costs

Overview

The final regulations provide the framework for determining the deductibility versus capitalization of costs incurred for materials and supplies, repairs and maintenance, and other tangible assets. Specifically, the final regulations provide rules in the following five general areas:

1. Materials and supplies
2. Capital expenditures in general (including the de minimis safe harbor)
3. Costs to acquire or produce tangible property
4. Costs to improve tangible property
5. Dispositions of MACRS property (including components thereof) and GAAs

Throughout each of the areas above, the final regulations retain many of the provisions of the temporary regulations, while also favorably clarifying, modifying and simplifying some of the provisions (e.g., a simplified de minimis safe harbor election). The final regulations also provide small business relief (i.e., a safe harbor election for improvements to eligible building property) and repropose new rules (i.e., for dispositions). Following is a discussion of the final rules governing acquisition costs and providing for special rules and safe harbors for improvement costs.

Amounts paid to acquire or produce tangible property

As with the temporary regulations, the final regulations under Reg. section 1.263(a)-2 generally continue to require taxpayers to capitalize costs paid or incurred to acquire, or facilitate the acquisition of, tangible personal and real property. However, both sets of regulations allow taxpayers to treat costs as nonfacilitative if they relate to the determination of whether to acquire real property and which real property to acquire (generally referred to as the "whether and which test"). The final regulations continue to limit this exception to real property despite commentators' requests to expand the whether and which test to investigational costs for the acquisition of personal property. Thus, taxpayers may only treat as nonfacilitative the costs incurred in determining whether and which property to acquire in the case of real property acquisitions.

Additionally, the final regulations continue to provide a list of inherently facilitative amounts that must be capitalized as part of the acquisition or production of real property, even if incurred under the whether and which test discussed above.² This list is unchanged from the temporary regulations; however, the final regulations clarify the meaning of contingency fees by providing that for purposes of Reg. section 1.263(a)-2, such fees include “an amount paid that is contingent on the successful closing of the acquisition of real or personal property.”³ Further, while inherently facilitative amounts may be allocated between the basis of property acquired and property not acquired, the final regulations provide that contingency fees must be included in the basis of property acquired and may not be allocated to the property not acquired.⁴

The final regulations continue to exclude employee compensation and overhead costs from the definition of amounts that facilitate an acquisition, but also continue to provide taxpayers with an election to treat such amounts as facilitative costs that are capitalizable under Reg. section 1.263(a)-2.⁵ As with the temporary regulations, such an election is made separately for each acquisition and may be applied to employee compensation, overhead or both. A taxpayer makes the election to treat employee compensation and/or overhead costs as facilitative (and thus capitalizable under Reg. section 1.263(a)-2) by capitalizing the amounts to which the election applies as amounts that facilitate the acquisition in the taxpayer’s timely filed, original tax return (i.e., no election statement is required).⁶ In the case of an S corporation or a partnership, the entity makes the election (not the shareholders or partners). Once made, the election is generally irrevocable and may not be changed through the filing of an application for change in accounting method.⁷

Taxpayers should note that acquisition or production costs properly included in the taxpayer’s de minimis safe harbor election are not treated as facilitative costs under Reg. section 1.263(a)-2 (and thus should not be capitalized as facilitative costs).⁸ However, even if an amount is treated as nonfacilitative (regardless of the provision under which the amount is treated as nonfacilitative), it could still be subject to capitalization under section 263A.⁹

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- 2 As provided by Reg. section 1.263(a)-2(f)(2)(ii), inherently facilitative amounts include: transportation fees; appraisal/valuation/pricing fees; negotiation and tax advisory fees; application fees, bidding fees or similar expenses; fees for preparing and reviewing the documents that effectuate the acquisition of the property; title examination and evaluation fees; regulatory approval or permit fees, including application fees; conveyance fees, including sales and transfer taxes and title registration fees; finders’ fees and brokers’ fees, including contingency fees; architectural, geological, surveying, engineering, environmental or inspection fees pertaining to particular properties; or fees for services provided by a qualified intermediary or other facilitator of an exchange under section 1031.
 - 3 Reg. section 1.263(a)-2(f)(3)(iii).
 - 4 Pursuant to Reg. section 1.263(a)-2(f)(3), inherently facilitative amounts, other than contingency fees, allocable to property that is not acquired may be allocated to such property and recovered as appropriate under the Internal Revenue Code and regulations (e.g., sections 165, 167 or 168).
 - 5 See Reg. section 1.263(a)-2(f)(2)(iv)(B).
 - 6 Taxpayers that did not make the election to capitalize employee compensation and/or overhead costs on their timely filed return for a tax year beginning on or after Jan. 1, 2012, and ending on or before Sept. 19, 2013, but desire to do so may still make the election by filing an amended return within 180 days of the extended due date of the applicable return. This transition rule applies regardless of whether the taxpayer extended its return. See Reg. section 1.263(a)-2(j)(2)(ii).
 - 7 Reg. section 1.263(a)-2(f)(2)(iv)(B).
 - 8 See Reg. sections 1.263(a)-2(f)(1), 1.263(a)-1(f)(3)(i) and 1.263(a)-1(f)(7), example 6.
 - 9 See Reg. sections 1.263(a)-2(c) and 1.263(a)-2(f)(4), example 7.

Summary of changes to the acquisition rules and effective dates

Issue	Temporary regulations	Final regulations
Amounts paid or incurred to acquire or produce tangible property		
Transaction costs	<ul style="list-style-type: none"> · Costs that facilitate the acquisition of real or personal property must be capitalized <ul style="list-style-type: none"> - Investigatory costs for real property not treated as facilitative costs (unless inherently facilitative) · 11 inherently facilitative costs 	<ul style="list-style-type: none"> · Similar · Contingency fees defined <ul style="list-style-type: none"> - Clarify that contingency fees must be allocated to the basis of property acquired
Employee compensation and overhead	<ul style="list-style-type: none"> · Generally not facilitative · Election to capitalize <ul style="list-style-type: none"> - Make separately for each acquisition for employee compensation, overhead or both - Made by capitalizing (i.e., no election statement required) on a timely filed, original tax return for the tax year the amounts are paid or incurred 	<ul style="list-style-type: none"> · Same · Same · Special transition rule for amounts paid or incurred in tax years beginning on or after Jan. 1, 2012, and ending on or before Sept. 19, 2013
Effective date: in general	<ul style="list-style-type: none"> · May be applied to tax years beginning on or after Jan. 1, 2012 (and before Jan. 1, 2014) 	<ul style="list-style-type: none"> · Must be applied to tax years beginning on or after Jan. 1, 2014 · May be applied to tax years beginning on or after Jan. 1, 2012
Effective date: investigatory costs for real property; employee compensation and overhead; and inherently facilitative amounts	<ul style="list-style-type: none"> · May be applied to amounts paid or incurred in tax years beginning on or after Jan. 1, 2012 (and before Jan. 1, 2014) 	<ul style="list-style-type: none"> · Must be applied to amounts paid or incurred in tax years beginning on or after Jan. 1, 2014 · May be applied to amounts paid or incurred in tax years beginning on or after Jan. 1, 2012

Amounts paid to improve tangible property

As with the temporary regulations, Reg. section 1.263(a)-3 generally requires taxpayers to capitalize costs paid or incurred for the improvement of tangible property, and also provides rules for determining when an amount is properly treated as a capitalizable improvement cost. As discussed below, the final regulations provide numerous clarifications, modifications and additions to the improvement rules provided by the temporary regulations that not only simplify and reduce the administrative burden of applying the rules, but also provide many taxpayer-favorable results as compared to the temporary regulations.

Unit of property

As with the temporary regulations, the unit of property (UOP) determination continues to be the foundation for the improvement versus repair analysis under the final regulations. The final regulations define UOPs in substantially the same manner as the temporary regulations; however, they provide clarification regarding amounts paid or incurred by a lessee with respect to leased property.

Under both the temporary and final regulations, a UOP is generally comprised of all components that are functionally interdependent. Special rules are provided for certain property, including buildings, plant property, network assets and leased property (other than buildings).¹⁰ While a building and its structural components are treated as one UOP, the improvement rules must be applied separately to one or more of eight defined building systems or the building structure, as applicable.¹¹ With respect to leased property, the lessee must determine the UOP in accordance with the general rules; however, the UOP cannot be larger than the portion of the property subject to the lease (including the building systems and structural components associated with the leased portion in the case of building property).¹²

Although substantially similar to the temporary regulations, the final regulations modify certain provisions related to leased property. Under the temporary regulations, a taxpayer-lessee was required to treat a leasehold improvement as a separate UOP from the leased property itself.¹³ This meant that any costs incurred with respect to the leasehold improvement were more likely to be considered improvement costs (as the UOP was inherently smaller than it would be if it included the overall leased property). The final regulations provide a favorable modification of this rule by providing that with respect to such property (whether building or nonbuilding), a lessee should *not* treat a leasehold improvement as a UOP separate from the leased property. Thus, under the final regulations, costs paid or incurred with respect to the leasehold improvement must be analyzed by determining whether such costs result in an improvement to the leased property as a whole (and not just to the leasehold improvement itself) in accordance with the general rules for building and nonbuilding property.¹⁴ Additionally, the final regulations clarify that if any lessee or lessor improvement is comprised of a building erected on leased property, the UOP for the building (and the application of the improvement rules) should be determined under the provisions for buildings rather than the provisions for leased buildings.¹⁵

Removal costs

Under the temporary regulations, it was unclear whether removal costs were required to be capitalized to the basis of replacement assets or components. Although the preamble to the temporary regulations provided that removal costs related to the removal of an entire UOP were not required to be capitalized,¹⁶ this rule was not explicitly stated in the regulations themselves. Additionally, the temporary regulations provided that if a component of a UOP was removed, the removal costs would be capitalizable improvement costs if they were determined to be indirect costs that directly benefitted or were incurred by reason of an improvement.¹⁷

The final regulations provide favorable clarifications and modifications to the temporary regulations for the treatment of removal costs. Specifically, pursuant to Reg. section 1.263(a)-3(g)(2), if a taxpayer disposes of a depreciable asset (including a partial disposition) and takes into account the adjusted basis of the asset (or portion of the asset) in determining gain or loss for federal income tax purposes,¹⁸ the costs of removing the asset (or component) are not required to be capitalized as improvement costs under Reg. section 1.263(a)-3. If a taxpayer disposes of a component of an asset but does not recognize the disposition for federal income tax purposes, however, the taxpayer must deduct or capitalize the removal costs based on whether such costs "directly benefit or are incurred by reason of a repair to the unit of property or an improvement to the unit of property."¹⁹

¹⁰ Other than as described herein, these rules are generally identical to the temporary regulations.

¹¹ Reg. section 1.263(a)-3(e)(2) defines eight building systems for this purpose as: (1) HVAC systems; (2) plumbing systems; (3) electrical systems; (4) all escalators; (5) all elevators; (6) fire-protection and alarm systems; (7) building security systems; and (8) gas distribution systems. Additionally, all structural components not included in one of the systems above is treated as part of the building structure unless specifically designated as a building system in published guidance.

¹² Reg. section 1.263(a)-3(e)(2)(v)(B).

¹³ See Reg. section 1.263(a)-3T(f)(1)(ii)(B).

¹⁴ Reg. section 1.263(a)-3(f)(2)(ii).

¹⁵ *Id.*

¹⁶ The preamble to the temporary regulations stated that the regulations were not intended to affect Rev. Rul. 2000-7, in which the IRS held that a taxpayer is not required to capitalize the costs of removing a retired depreciable asset.

¹⁷ See *id.* and Reg. section 1.263(a)-3T(f)(3)(i).

¹⁸ See the fourth article in this series for a discussion of the proposed regulations governing full and partial dispositions and partial dispositions of tangible assets.

¹⁹ Reg. section 1.263(a)-3(g)(2)(i).

Although the removal cost clarifications contained in the regulations are generally favorable, taxpayers should keep in mind that even though the removal costs themselves may be deductible, if a taxpayer does recognize the disposition of an asset or component for federal income tax purposes, it will be required to capitalize the costs paid or incurred for replacing the asset or component as a restoration under Reg. section 1.263(a)-3(k)(1).²⁰

Small taxpayer safe harbor

A significant change was made by the final regulations through the addition of a safe harbor to allow certain taxpayers to refrain from treating as improvement costs any costs paid or incurred for the repair, maintenance or improvement of building property.

Pursuant to Reg. section 1.263(a)-3(h), a qualifying small taxpayer may elect to not apply the improvement rules to an eligible building if the total amount paid during the taxable year for repairs, maintenance, improvements and similar activities performed on the building does not exceed the lesser of: (i) \$10,000; or (ii) 2 percent of the unadjusted basis of the building.²¹ A qualifying small taxpayer includes a taxpayer whose average annual gross receipts for the three preceding taxable years are \$10 million or less.²² Reg. section 1.263(a)-3(h)(3) provides rules for determining a taxpayer's average annual gross receipts, as well as a definition of gross receipts for this purpose. The rules generally comply with those for determining the average annual gross receipts of taxpayers under sections 448(c)²³ and 263A(b)²⁴ but, notably, do not include any aggregation requirements.²⁵ Thus, taxpayers may determine whether they constitute a "qualifying taxpayer" without having to look beyond their own gross receipts. An eligible building includes a building that is owned or leased by the qualifying small taxpayer if the unadjusted basis of the building property is \$1 million or less.²⁶ If the small taxpayer safe harbor is applicable and elected, a qualifying taxpayer is not required to apply the improvement standards to owned or leased eligible buildings.

In determining amounts paid for repairs, maintenance and improvements during the taxable year, taxpayers must include amounts falling within the de minimis safe harbor (if elected) and the routine maintenance safe harbor for buildings (if used under the taxpayer's method of accounting). Thus, while the safe harbors are meant to alleviate the burden of tracking certain expenditures, taxpayers should note that they will still need to be able to track costs for repairs, maintenance and improvement activities for purposes of determining whether they satisfy the small taxpayer safe harbor, even if such amounts escape capitalization under another safe harbor or provision.

The election to apply the small taxpayer safe harbor is made on an annual and eligible-building-by-building basis.²⁷ Thus, qualifying taxpayers have a great amount of flexibility in choosing (1) whether to make the election, and (2) for which eligible buildings to apply the election. However, before an election to apply the safe harbor may be made, taxpayers will need to determine on an annual basis whether (1) they meet the definition of a qualifying small taxpayer, and (2) whether the amount paid for repair, maintenance and improvement activities with respect to an eligible building falls below the ceiling

20 See the third article in this series for a discussion of the treatment of costs paid or incurred to restore a UOP under the final regulations.

21 Reg. section 1.263(a)-3(h)(1).

22 Reg. section 1.263(a)-3(h)(3).

23 These rules exempt certain taxpayers with prior three-year average annual gross receipts of \$5 million or less from the requirement to use an overall accrual method of accounting.

24 These rules exempt certain taxpayer-resellers with prior three-year average annual gross receipts of \$10 million or less from the UNICAP requirements.

25 Generally, where exceptions from certain accounting method rules are provided to taxpayers with less than a certain amount of gross receipts, such excepting provisions require the taxpayer to aggregate its gross receipts with related entities where such entities and the taxpayer would be considered a single employer within the meaning of section 52(a) or (b) or section 414(m) or (o). This generally means that all entities within a consolidated group or with common ownership will be required to aggregate their gross receipts. In addition to sections 448 and 263A, see also Rev. Procs. 2001-10 and 2002-28.

26 Reg. section 1.263(a)-3(h)(4).

27 Reg. section 1.263(a)-3(h)(6).

amount. Further, if the relevant costs for a taxable year exceed the lesser of 2 percent of the building's unadjusted basis or \$10,000, the safe harbor will not apply to any costs incurred with respect to the building for that year. Additionally, it's important to keep in mind that this safe harbor only applies to expenditures with respect to eligible buildings (i.e., building improvements) and cannot be used to avoid applying the improvement rules to expenditures with respect to any nonbuilding property.

A qualifying taxpayer elects the small taxpayer safe harbor annually by including a statement with the following information in its timely filed, original tax return for the year of election:²⁸

Section 1.263(a)-3(h) Safe Harbor Election for Small Taxpayers

Taxpayer's name
Taxpayer's address
Taxpayer's identification number
Description of each eligible building property to which the taxpayer is applying the election

The amounts paid for repairs, maintenance, improvements and similar activities performed on the eligible building(s) described above qualify under the safe harbor provided in Reg. section 1.263(a)-3(h)(1).²⁹

In the case of an S corporation or a partnership, the entity makes the election (not the shareholders or partners). Once made, the election is generally irrevocable and may not be changed through the filing of an application for change in accounting method.

Routine maintenance safe harbor

As with the temporary regulations, the final regulations continue to allow for a routine maintenance safe harbor for nonbuilding property. However, unlike the temporary regulations, the final regulations favorably expand the safe harbor to building property, with certain modifications to the general safe harbor rules. Under the final regulations, a taxpayer may apply the routine maintenance safe harbor to recurring activities undertaken to keep a building UOP in ordinarily efficient operating condition if the taxpayer "reasonably expects to perform the activities more than once during the 10-year period beginning at the time the building structure or building system upon which the routine maintenance is performed is placed in service by the taxpayer."³⁰ Taxpayers should note that while a shortened 10-year period is provided for purposes of routine maintenance performed on building property, the final regulations continue to provide that for the safe harbor to apply to property other than buildings, the activities must be reasonably expected to be performed more than once during the alternative depreciation system (ADS) class life of the nonbuilding property.³¹ The final regulations also clarify that even if the routine maintenance activities are not in fact performed more than once during the applicable time frame, a taxpayer may still be able to apply the safe harbor if it can substantiate that it had at the time the property was placed in service a reasonable expectation that the activities would be performed more than once.³²

Finally, the final regulations retain the temporary regulations' exclusions from the safe harbor and add several additional exclusions. Now, the safe harbor expressly excludes amounts paid for: a betterment to the UOP; an adaptation of the UOP to a new or different use; a restoration to the UOP (other than rebuilding the UOP to a like-new condition after the end of its ADS class life or replacing a major component or substantial structural part); the repair, maintenance or improvement of network assets; and the repair, maintenance or improvement of rotatable and temporary spare parts to which the optional method under Reg. section 1.162-3(e) is applied.³³

²⁸ Pursuant to Reg. section 1.263(a)-3(h)(6), qualifying small taxpayers that did not make the election to apply the safe harbor to eligible building property on their timely filed return for a tax year beginning on or after Jan. 1, 2012, and ending on or before Sept. 19, 2013, but desire to do so may still make the election by filing an amended return within 180 days of the extended due date of the applicable return. This transition rule applies regardless of whether the taxpayer extended its return.

²⁹ Reg. section 1.263(a)-3(h)(6).

³⁰ Reg. section 1.263(a)-3(i)(1)(i).

³¹ See Reg. section 1.263(a)-3(i)(1)(ii).

³² See Reg. section 1.263(a)-3(i)(6), example 8 for an illustration of this clarification.

³³ Reg. section 1.263(a)-3(i)(3).

While eligible amounts are generally deductible in the year incurred (i.e., they are not treated as improvement costs), taxpayers should keep in mind that such amounts may still be subject to capitalization under section 263A.³⁴ Additionally, and unlike several of the other safe harbors provided in the final regulations, the use of the routine maintenance safe harbor is considered a method of accounting that must generally be implemented through the filing of a Form 3115 (i.e., cannot be applied annually through an election).

Election to capitalize repair and maintenance costs

Under the temporary regulations, taxpayers did not have an option to capitalize (as an improvement) amounts that were properly characterized as repair and maintenance costs. The final regulations give taxpayers the ability to minimize book-tax differences by providing for an election to capitalize repair costs to the extent such costs are capitalized for book purposes.³⁵ Pursuant to Reg. section 1.263(a)-3(n), a taxpayer may elect to treat amounts paid or incurred during the taxable year for the repair and maintenance of tangible property as amounts paid or incurred to improve that property under Reg. section 1.263(a)-3(d). Taxpayers must incur the costs in carrying on a trade or business and may only elect to capitalize the costs to the extent such costs are capitalized for the taxpayer's books and records.³⁶

A taxpayer that makes the election under Reg. section 1.263(a)-3(n) must treat all amounts paid for the repair and maintenance of tangible property as improvements to such property to the extent that the taxpayer capitalizes such amounts in its books and records for the taxable year of election. However, the election does not apply to amounts paid or incurred for the repair or maintenance of rotatable or temporary spare parts for which the taxpayer applies the optional method of accounting under Reg. section 1.162-3(e). A taxpayer elects to capitalize such amounts by including a statement with the following information on its timely filed, original tax return for the year of election:³⁷

Section 1.263(a)-3(n) Election

Taxpayer's name
Taxpayer's address
Taxpayer's identification number

The taxpayer is making the election to capitalize repair and maintenance costs under Reg. section 1.263(a)-3(n).³⁸

In the case of a consolidated group, the common parent should make the election, and the statement above must include the names and taxpayer identification numbers of each member for which the election is being made. In the case of an S corporation or a partnership, the entity makes the election (not the shareholders or partners). Once made, the election is generally irrevocable and may not be changed through the filing of an application for change in accounting method.

34 Reg. section 1.263(a)-3(i)(5).

35 See Reg. section 1.263(a)-3(n).

36 Reg. section 1.263(a)-3(n)(1).

37 Pursuant to Reg. section 1.263(a)-3(r)(2)(ii), taxpayers that did not make the election to capitalize repair and maintenance costs under Reg. section 1.263(a)-3(n)(2) on their timely filed return for a tax year beginning on or after Jan. 1, 2012, and ending on or before Sept. 19, 2013, but desire to do so may still make the election by filing an amended return within 180 days of the extended due date of the applicable return. This transition rule applies regardless of whether the taxpayer extended its return.

38 Reg. section 1.263(a)-3(n)(2).

Summary of changes to the improvement rules

Issue	Temporary regulations	Final regulations
Amounts paid or incurred to improve tangible property: Unit of property (Reg. section 1.263(a)-3(e) and (f))		
Definitions	<ul style="list-style-type: none"> · Functionally interdependent components · Special rules for: <ul style="list-style-type: none"> - Buildings—each building, including its structural components, but improvement rules applied separately to each of eight applicable defined building systems and/or building structure - Plant property—discrete and major function within group of functionally interdependent machinery or equipment - Network assets—facts and circumstances except as otherwise provided in published guidance - Leased buildings (lessee)—entire building or portion of building subject to lease, but improvement rules applied separately to each of eight applicable defined building systems and/or building structure <ul style="list-style-type: none"> • Leasehold improvements treated as separate UOPs from leased property being improved - Leased property other than buildings—apply general rules depending on type of property, but UOP may not be larger than property subject to lease <ul style="list-style-type: none"> • Leasehold improvements treated as separate UOPs from leased property being improved 	<ul style="list-style-type: none"> · Similar rules to temporary regulations, except: <ul style="list-style-type: none"> - Leasehold improvements are not UOPs separate from leased property being improved - If any lessee/lessor improvement is comprised of a building erected on leased property, the UOP for the building (and the application of the improvement rules) should be determined under provisions for buildings rather than the provisions for leased buildings
Effective date	<ul style="list-style-type: none"> · May be applied to tax years beginning on or after Jan. 1, 2012 (and before Jan. 1, 2014) 	<ul style="list-style-type: none"> · Must be applied to tax years beginning on or after Jan. 1, 2014 · May be applied to tax years beginning on or after Jan. 1, 2012

Issue	Temporary regulations	Final regulations
Amounts paid or incurred to improve tangible property: Special rules for determining improvement costs (Reg. section 1.263(a)-3(g))		
Removal costs	<ul style="list-style-type: none"> · Preamble provides that costs paid or incurred for the removal of an entire depreciable asset are not required to be capitalized · All other removal costs must be analyzed to determine whether they directly benefit or are incurred by reason of an improvement to a UOP 	<ul style="list-style-type: none"> · Regulations explicitly provide removal costs are not required to be capitalized if taxpayer recognizes a full or partial disposition of removed asset or component · If no disposition is recognized, must determine whether removal costs directly benefit or are incurred by reason of an improvement to a UOP
Effective date	<ul style="list-style-type: none"> · May be applied to tax years beginning on or after Jan. 1, 2012 (and before sJan. 1, 2014) 	<ul style="list-style-type: none"> · Must be applied to tax years beginning on or after Jan. 1, 2014 · May be applied to tax years beginning on or after Jan. 1, 2012

**Amounts paid or incurred to improve tangible property:
Small taxpayer safe harbor (Reg. section 1.263(a)-3(h))**

Eligibility	<ul style="list-style-type: none"> · N/A 	<ul style="list-style-type: none"> · Qualifying small taxpayers may elect to not apply the improvement rules to expenditures related to eligible building property · Qualifying taxpayer—\$10 million or less in average annual gross receipts for three prior taxable years · Eligible property—building UOP with unadjusted basis of \$1 million or less · Amounts for repair, maintenance and improvement expenses must not exceed lesser of: <ul style="list-style-type: none"> - 2 percent of unadjusted basis; or - \$10,000 · If amounts exceed ceiling, may not apply safe harbor to any amounts
Election statement	<ul style="list-style-type: none"> · N/A 	<ul style="list-style-type: none"> · Election made on annual and eligible-building-by-building basis · Election statement required for each year election is being made and must be included with timely filed return
Effective date	<ul style="list-style-type: none"> · N/A 	<ul style="list-style-type: none"> · Applicable for amounts paid or incurred in tax years beginning on or after Jan. 1, 2014 · May be applied to amounts paid or incurred in tax years beginning on or after Jan. 1, 2012 · Special transition rule for amounts paid or incurred in tax years beginning on or after Jan. 1, 2012, and ending on or before Sept. 19, 2013

Issue	Temporary regulations	Final regulations
Amounts paid or incurred to improve tangible property: Routine maintenance safe harbor (Reg. section 1.263(a)-3(i))		
Nonbuilding property	<ul style="list-style-type: none"> · Taxpayer must reasonably expect to perform routine maintenance activity more than once during the ADS class life of the UOP 	<ul style="list-style-type: none"> · Same as temporary regulations · Clarifies safe harbor may still apply even if activity is not actually performed more than once during applicable time frame
Building property	<ul style="list-style-type: none"> · N/A 	<ul style="list-style-type: none"> · Taxpayer must reasonably expect to perform routine maintenance activity more than once within 10 years of placing applicable building system or structure in service · Safe harbor may still apply even if activity is not actually performed more than once during 10-year period
Ineligibility	<ul style="list-style-type: none"> · Does not apply to amounts paid for: <ul style="list-style-type: none"> - Restorations (other than amounts paid to rebuild the property to a like-new condition after the end of its ADS class life and/or amounts paid for the replacement of a major component or substantial structural part) - Rotable and temporary spare parts for which the optional method of accounting is applied 	<ul style="list-style-type: none"> · Retains temporary regulation exclusions and adds exclusion of amounts paid for: <ul style="list-style-type: none"> - Betterments - Adaptations to a new or different use - Repairs, maintenance or improvements of network assets
Application	<ul style="list-style-type: none"> · Method of accounting (cannot be made through an annual election) 	<ul style="list-style-type: none"> · Same as temporary regulations
Effective date	<ul style="list-style-type: none"> · May be applied to tax years beginning on or after Jan. 1, 2012 (and before Jan. 1, 2014) 	<ul style="list-style-type: none"> · Must be applied to tax years beginning on or after Jan. 1, 2014 · May be applied to tax years beginning on or after Jan. 1, 2012

Issue	Temporary regulations	Final regulations
Amounts paid or incurred to improve tangible property: Election to capitalize repair and maintenance costs (Reg. section 1.263(a)-3(n))		
Election to capitalize repair and maintenance costs	<ul style="list-style-type: none"> · N/A 	<ul style="list-style-type: none"> · May annually elect to treat repair and maintenance costs capitalized in books and records as improvement costs · Does not apply to amounts paid or incurred for rotables accounted for under optional method · If made, election applies to all repair and maintenance costs capitalized in books and records for year of election
Election statement	<ul style="list-style-type: none"> · N/A 	<ul style="list-style-type: none"> · Election statement required for each year election is made and must be included with timely filed return
Effective date	<ul style="list-style-type: none"> · N/A 	<ul style="list-style-type: none"> · Applicable for amounts paid or incurred in tax years beginning on or after Jan. 1, 2014 · May be applied to amounts paid or incurred in tax years beginning on or after Jan. 1, 2012 · Special transition rule for amounts paid or incurred in tax years beginning on or after Jan. 1, 2012, and ending on or before Sept. 19, 2013

Implications

The final regulations governing acquisitions of and improvements to tangible property are generally taxpayer-favorable and provide helpful clarifications and guidance. The regulations not only provide opportunities to reduce book-tax differences (e.g., through the election to capitalize repair and maintenance costs), but they also reduce administrative burdens and increase flexibility in (1) determining whether to capitalize certain costs, and (2) applying the improvement rules to specified expenditures (e.g., through the election to capitalize employee compensation and/or overhead costs and the small taxpayer safe harbor election for improvements to building property).

Taxpayers should note that while certain safe harbors and rules are applied through annual elections (and thus are not considered methods of accounting), certain other rules under the final regulations, such as the application of the general improvement standards and the routine maintenance safe harbor, are considered methods of accounting (and thus may only be changed through the filing of one or more Forms 3115). To the extent a safe harbor or special rule is applied through an annual election, taxpayers should note that such election must generally be made on a timely filed tax return. However, the final regulations generally provide for a special transition rule for taxpayers that desire to apply one or more elections to amounts paid or incurred in taxable years beginning on or after Jan. 1, 2012, and ending on or before Sept. 19, 2013. Under these rules, taxpayers have a limited-time opportunity to amend their tax returns for such years to apply one or more of the elections under the final regulations.

Because the final regulations provide for opportunities to either reduce or increase current-year taxable income, taxpayers should evaluate whether early adopting one or more of the final regulation provisions for their taxable years beginning on or after Jan. 1, 2012, and ending on or before Dec. 31, 2013, is advantageous in light of their current-year taxable income goals.

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