



Summary of Tangible Property Regulations (TPRs)

[Important Notice Regarding TPRs](#)

Capitalization or deduction

The regulations state the general rule that amounts paid to improve a unit of property must be capitalized. An improvement is defined as an expenditure that betters a unit of property, restores it, or adapts it to a new and different use.

However, the regulations allow a current deduction for repairs and maintenance to property. Deductible repair and maintenance expenses are defined negatively—if not otherwise required to be capitalized, they are deductible.

Unit of property

A key concept in the regulations is the “unit of property” (UOP) concept. This concept defines an asset that is being improved or repaired. The smaller the UOP, the more likely that costs incurred in connection with it will have to be capitalized.

For example, work on an engine of a vehicle is more likely to be classified as an expense that must be capitalized if the engine is classified as a separate UOP. By contrast, if the UOP is the vehicle, the engine work has a better chance of passing muster as a repair.

Property other than buildings

In general, for property other than buildings, a single UOP consists of all components that are functionally interdependent, such that one component cannot be placed in service without the other components.

For example, if a business buys a battery-powered vehicle for its foreman to use in getting around a large warehouse and buys the chassis from one vendor and the battery from another, and assembles the two components, the vehicle is the UOP, since the chassis cannot be placed in service without the battery.

Buildings

The regulations generally treat each building and its structural components as one UOP—the “building.” The regulations also list nine specific building systems that are treated as separate from the building structure. An improvement to the building is defined by its effect on those systems, rather than on the building as a whole.

If a taxpayer restores a building structure, such as replacing the entire roof, the expense is treated as an improvement to the single UOP consisting of the building. If the taxpayer makes an improvement to a building system, such as the heating, ventilation, and air conditioning (HVAC) system, that expense is also an improvement to the building UOP.

Deducting materials and supplies

A deduction is allowed for amounts paid to produce and acquire materials and supplies that are consumed during the year. Materials and supplies are defined to include five specific categories of property used or consumed in the business operations.

UOPs with an economic useful life of no more than 12 months qualify as materials and supplies under this rule. Certain inexpensive items that cost \$200 or less to acquire or produce qualify as materials and supplies.

De minimis safe harbor

The regulations allow a taxpayer to deduct certain limited amounts paid for tangible property that are expensed for financial accounting purposes. The safe harbor amount depends on whether the taxpayer has an applicable financial statement (AFS). An AFS can be a certified audited financial statement that is used for credit purposes, for reporting to partners, or for other non-tax purposes.

A taxpayer with an AFS may rely on the de minimis safe harbor if no more than \$5,000 per invoice, or per item as substantiated by the invoice, was paid for the property. For businesses without an AFS, the maximum figure is \$500 rather than \$5,000.

To use the safe harbor, the business must have accounting procedures in place at the beginning of the tax year that treat as an expense amounts paid for property with less than a specified dollar amount or with an economic useful life of 12 months or less.

Routine maintenance safe harbor

The regulations include a safe harbor that allows certain expenses of routine maintenance to be deducted rather than capitalized. Routine maintenance means recurring activities that keep business property, including buildings, in ordinarily efficient operating condition, such as inspection, cleaning, testing, and replacement of damaged or worn parts. The taxpayer must expect to perform the maintenance at least twice during the IRS-mandated life of the asset to use this safe harbor.

For a building structure or system, the taxpayer must reasonably expect to perform the maintenance more than once during the 10-year period that begins when the structure or system is placed in service. For property other than buildings, the taxpayer must reasonably expect to perform the activities more than once during the property's class life for depreciation purposes.

Per-building safe harbor for qualifying small taxpayers

Qualifying small taxpayers—those with average annual gross receipts of \$10 million or less in the three preceding tax years—can deduct improvements made to a building property with an unadjusted basis of \$1 million or less. This safe harbor applies only if the total amount paid during the tax year for repairs, maintenance, and improvements to the building does not exceed the lesser of \$10,000 or 2% of the building's unadjusted basis.

This safe harbor may be elected annually on a building-by-building basis. It is elected by including a statement on the tax return for the year the costs are incurred for the building. We can help you take advantage of this rule by filing the necessary election.

Accounting method changes

A change to conform to the regulations is considered a change in accounting method, for which an accounting adjustment may be required. The IRS has issued procedures under which taxpayers can get automatic consent to the accounting method change.

The IRS has also created a number of special procedures for small businesses—those with less than \$10 million of assets or \$10 million or less of average gross receipts—that limit the accounting changes needed to adopt the regulations.

For some taxpayers, it will not be advantageous to avail themselves of the “small business” relief. For example, if the sum of all of the 481(a) adjustments for changes eligible for the relief is a substantial favorable adjustment, the taxpayer would be better off filing the Form(s) 3115, and taking the taxpayer-friendly deduction.

Taxpayers who do not meet the “small business taxpayer” rules above, and who have tangible assets or real property, are required to file Form(s) 3115 with their 2014 tax return.