



The new repair and maintenance regulations

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Presenters



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- > Overview
- > Improvements
- > MACRS groupings and dispositions
- > Acquisitions
- > Materials and supplies
- > Next steps

Overview: Key practical considerations



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- > Effective date generally Jan. 1, 2012
- > Many changes from 2008 proposed regulations and current law
- > Apply to taxpayers that acquire, produce, or improve tangible property
- > Potential administrative burdens
- > Inadvertent elections
- > Likely 481(a) adjustments

*Evaluate your accounting methods
and capitalization policies*

Overview: Outline of new regulations



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Materials and supplies	Acquisitions	Improvements	General asset accounts, MACRS dispositions
Treas. Reg. §1.162-3T	Treas. Reg. §1.263(a)-2T	Treas. Reg. §1.263(a)-3T	Treas. Regs. §1.168(i)-1T and §1.168(i)-8T
<ul style="list-style-type: none"> • Expanded definition • Rotable and temporary spare parts • De minimis rule 	<ul style="list-style-type: none"> • Transaction costs • Costs prior to placed in service date • De minimis rule 	<ul style="list-style-type: none"> • Unit of property • Betterments • Restorations • Adaptations • Routine maintenance safe harbor 	<ul style="list-style-type: none"> • General asset account elections • Qualifying dispositions and loss recognition • MACRS dispositions

Overview: What's new?



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- > Building systems concept
- > Revised definition of major component/substantial structural part of a building
- > Revised routine maintenance safe harbor
- > Revised disposition rules
- > De minimis rule for acquisitions
- > Expanded definition of materials and supplies
- > Optional method of accounting for rotatable and temporary spare parts

Unit of property (UoP) – key concept

- > Buildings
- > Other property
 - Functional interdependence test for property other than buildings (e.g., office equipment, furniture, vehicles)
 - Special rules for plant property and network assets

- > Building structure
- > Building systems
 - HVAC
 - Plumbing
 - Electrical
 - Escalators
 - Elevators
 - Fire protection
 - Security
 - Gas distribution

Improvements: Unit of property



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Unit of property for a building	Improvement tests		Capitalize improvements
Building and structural components	Building structure	Separate building systems <ul style="list-style-type: none">• HVAC• Plumbing• Electrical• Escalators• Elevators• Fire protection• Security• Gas distribution	Building and structural components

- > Other rules
 - Leased buildings
 - Lessee and lessor improvements
 - Depreciation consistency rule: cost segregation studies
- > A change in the unit of property is a change in method of accounting

***Do you know what your
units of property are for
repair and maintenance
expenditures?***

Improvements: Three tests



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- > Betterment
- > Restoration
- > Adaptation

- > What is a betterment?
 - Amelioration of a material condition or defect
 - Material addition or expansion
 - Material increase in quality, capacity, efficiency, productivity, strength
- > “It is appropriate to consider all facts and circumstances” → **SUBJECTIVE**

- > Retail store examples
 - Refresh/re-image
 - Refresh/re-image + limited improvement
 - Substantial remodel
- > The answer depends on facts and circumstances

- > Costs incurred during an improvement
 - A taxpayer must capitalize all direct costs of an improvement and all the indirect costs, including otherwise deductible repair costs, that directly benefit or are incurred by reason of the improvement

> What is a restoration?

- Replacement after recognizing a loss on disposal
- Replacement after a sale or exchange
- Repair after a casualty loss
- Return to ordinary operating condition if deteriorated to state of disrepair
- Rebuild to a like-new condition after end of class life
- Replacement of major component or substantial structural part of the UoP

- > Major component or substantial structural part
 - A part of combination of parts that comprise a large portion of the physical structure of the UoP or that performs a discrete and critical function in the operation of the UoP
 - The replacement of a minor component, even though it may affect the function of the UoP, generally will not, by itself, constitute a major component or substantial structural part
- > 50% tests in proposed regs eliminated, facts and circumstances analysis required

- > What is an adaptation?
 - Changing a UoP to a new or different use that is not consistent with its ordinary intended use at the time it is originally placed in service

Improvements: Routine maintenance safe harbor



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- > Not applicable to buildings and structural components – major change from 2008 proposed regulations
- > Activities that a taxpayer expects to perform more than once during the class life of the UoP to keep it in ordinarily efficient operating condition
 - Recurring nature of the activity
 - Industry practice
 - Manufacturer's recommendations
 - Taxpayer's experience
- > Prior owner's use vs. new owner's use

- > Depreciation grouping rules
 - Single asset account (SAA)
 - Multiple asset account (MAA)
 - General asset account (GAA)

- > What is a general asset account?
- > Eligible assets
 - Placed in service in the same tax year
 - Same depreciation method
 - Same recovery period
 - Same convention
- > GAA disposition rules
 - Generally, no loss recognized

- > Disposition of an asset: transfer of ownership or permanent withdrawal from use
- > Qualifying dispositions from GAAs
 - Sale or exchange
 - Retirement
 - Physical abandonment
 - Destruction
 - Transfer to supplies or scrap
 - Involuntary conversion
 - Retirement of a structural component of a building

- > Dispositions of structural components and defined building systems – common sense approach
 - Old rules: multiple versions of the same component or system on the books
 - New rules: capitalize the new, write off the old
- > May help mitigate the impact of the smaller UoP standards for buildings
- > New regulations allow for *any reasonable method* to determine basis of disposed assets

- > General MACRS disposition rules
 - Includes retirement of structural components
 - Loss recognition is mandatory: **trap for the unwary!**
 - Potentially significant administrative burden
- > Dispositions of property from a GAA
 - “Qualifying disposition” includes retirement of structural components
 - Loss recognition is optional
 - Easier to administer (assuming transition relief), but no current deduction for retired components

***Have you made a
general asset election?***

- > Amounts paid to acquire or produce real property or tangible personal property must be capitalized
- > Certain direct and indirect costs must be capitalized to property produced and/or acquired for resale

- > Amounts paid to facilitate the acquisition or production of real or personal property must be capitalized
 - “Inherently facilitative” costs
 - Real estate “whether and which” costs
 - Costs for work performed prior to placing the property in service

- > Costs to acquire or produce property do not have to be capitalized if the taxpayer:
 - Has an “applicable financial statement” (AFS),
 - Has a written accounting policy for expensing acquisition costs less than a certain dollar amount,
 - Expenses those costs on its AFS in accordance with its policy, and
 - Does not exceed the ceiling amount.

- > Ceiling amount: the aggregate amount paid and not capitalized under the de minimis rule must be less than or equal to the greater of:
 - 0.1% of gross receipts for federal income tax purposes
 - 2% of total depreciation and amortization expense in its AFS

- > Expanded definition of materials and supplies
 - Components acquired to maintain, repair, or improve a unit of tangible property that are not acquired as part of that unit of property,
 - Fuel, lubricants, water, and similar items that are reasonably expected to be consumed in 12 months or less,
 - A UoP with an economic useful life of 12 months or less,
 - A UoP with an acquisition or production cost of \$100 or less, or
 - Tangible property identified in published guidance

- > General rules for materials and supplies
 - Incidental: costs deductible when paid
 - Non-incidental: costs deductible when items are used or consumed in taxpayer's business
- > More flexibility under new rules
 - Use de minimis rule for materials and supplies
 - Elect to capitalize and depreciate
 - Use optional method for rotatable and temporary spare parts

- > Rotable and temporary spare parts
 - Rotable spare parts: removable from a UoP, repaired or improved, reinstalled, or stored for later use
 - Temporary spare parts: used temporarily until a new or repaired part is installed, stored for later use
- > Three methods
 - Deduct cost when parts are disposed
 - Capitalize and depreciate
 - Use new optional method

Have you filed an application for change in accounting method (Form 3115) for repair and maintenance expenditures during the last five years?

- > New rules generally effective for tax years beginning on or after Jan. 1, 2012
- > Public comment period through March 26; public hearing April 25
- > A change to comply with the new rules is a **change in method of accounting → 481(a) adjustment**
- > Transition rules coming “soon”
 - GAA election?
 - 3115 five-year rule?
 - Guidance for 2011?

Next steps



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- > Evaluate your accounting methods and capitalization policies
- > Evaluate your facts and circumstances
- > Evaluate your risks
- > Contact us with questions

Questions

Contact information



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