IRS Postpones New Tax Rules for Repairs

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After the IRS issued new temporary regulations in 2011 distinguishing "repairs" from "capitalized expenses," many questions remained about these complex rules. Now the IRS has announced a brief reprieve: The temporary regulations, as well as upcoming final regulations, will not take effect for business taxpayers until tax years beginning after 2013 (although business taxpayers may continue to apply them to tax years beginning after 2011). The IRS also added conforming amendments to the new rules.

The IRS initially said it does not intend to make many substantive changes in the final regulations. However, it has been criticized for using "facts-and-circumstances" tests in the temporary regulations, presenting the sort of scenarios that have often resulted in conflicts in the past. Thus, the IRS is facing pressure from the tax community to provide more bright-line tests and safe-harbor rules.

The basic approach for business taxpayers is that repairs are currently deductible, while improvements are capitalized and written off over time. But it is often difficult to distinguish a repair from an improvement for tax purposes. Some of the key areas covered in the temporary regulations are:

Definition of repairs: The temporary regulations clarify that a business may deduct amounts paid to repair and maintain tangible property as long as the payments do not have to be capitalized under the tax law.

Materials and supplies: The definition of materials and supplies is expanded to provide an optional method of accounting for rotable and temporary spare parts. This includes a de minimis election for certain materials and supplies.

Rentals and leased property: The cost of erecting a building or making a permanent improvement to leased property is treated as a capital expenditure. However, leasehold improvements must be depreciated or amortized under the applicable depreciation period, rather than the lease term.

Payments to acquire or produce tangible property: The new regulations generally retain rules from proposed regulations for capitalizing amounts paid to acquire or produce units of tangible property. This includes requirements to capitalize acquisition and production costs, as well as amounts paid to defend and perfect title to property. Furthermore, the temporary regulations explain the treatment for moving and reinstallation costs, transactional costs and the de minimis rule.

MACRS property: The rules for accounting for property under the Modified Accelerated Cost Recovery System (MACRS) are revised under the temporary regulations. They spell out the method for determining gain or loss on the disposition of MACRS property.

Payments to improve property: The temporary regulations retain simplified conventions to determine a unit of property and establish if such units have been improved. They also retain a "routine maintenance safe harbor" and an optional regulatory accounting method. But be aware that numerous other technical changes are included.

As you can see, the temporary regulations are extremely complex. If your business expects to incur these types of expenses in the near future, it is strongly recommended that you contact your Henry & Horne, LLP professional adviser.

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