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Reminder: IRS' depreciation changes will affect every return

The IRS has finalized the regulations which are commonly known as the "repair regulations" (hereafter known as "Regs"). These complex Regs are effective for tax years beginning on or after January 1, 2014 and provide detailed guidance as to the extent a taxpayer is required to capitalize (and not presently deduct) the cost of tangible property. The IRS is mandating businesses adopt certain policies and make accounting method change election statements in their tax returns. Many of the changes in accounting methods required by these regulations require the filing of additional forms and will require both your business and us to spend additional time to prepare your returns this year. Unfortunately, the cost to comply with the new regulations is not optional.

We anticipate that every business will be affected by these Regs and recommend that businesses adopt a capitalization policy and review its depreciation schedules before year-end. While several rules are onerous, there are several that provide tax reduction opportunities. We are writing this letter to assist you with keeping better records for repairs, maintenance and supplies, understand how to analyze and classify these items, and take advantage of tax reduction opportunities. Here is a summary of the new rules and steps to follow to comply with the new IRS Regs.

<u>Materials and Supplies</u>
You are now allowed to write off any individual supply items costing $200 or less that last for 12 months or less. Evaluate any supply costing more than $200 to determine if they can be expensed or if they must be capitalized and depreciated over several years.

<u>Equipment Repairs and Maintenance</u>
You are now allowed to expense any individual **equipment** item or repair/maintenance item costing $500 or less ($5,000 with audited financial statements). Analyze items above the $500/$5,000 to determine if they can be expensed or if they must be capitalized and depreciated over several years.

Opportunity: If you have previously capitalized supplies included with equipment invoices, you are allowed to expense the remaining basis.

<u>Unit of Property (UofP)</u>
The IRS requires you to examine individual items above the $500/$5,000 limit to determine if the item has been a betterment, restoration, or adaption to the UofP. A UofP is defined as the inter-related parts composing one larger unit (a car is a unit of property composed of inter-related parts). A building as a whole is a UofP. In addition the IRS has determined that the following

structural components of a building are also UofP's: HVAC, plumbing, electrical, escalators, elevators, fire protection/alarm systems, security systems, or gas distribution systems. Future references to Building in this letter apply to both the Building and its Structural Components.

Betterment: Fixing a condition that existed at purchase, increase size or capacity of the asset.
Restoration: Restoring the asset to an efficient operating condition, rebuilding the asset after its useful life; replacing a major component of the asset.
Adaptation: Changing the function of the asset to a new or different use.

Opportunity: Invoices should be reviewed to determine the unit cost of an asset rather than capitalizing the entire invoice.

Building Repairs and Maintenance – Small Taxpayers – Gross Receipts Less than $10 Million
If the building has a cost basis of $1 Million or less and the total amount paid during the taxable year for repairs, maintenance, improvements and similar activities do not exceed the lesser of $10,000 or 2% of the basis of the building, the entire amount of these costs may be expensed. If the taxpayer chooses to expense these items, an election must be attached to the timely filed tax return.

Routine Maintenance Safe Harbor – Equipment
If a taxpayer expects to perform routine maintenance on a piece of equipment more than once in its class life (6-20 years), the cost can be expensed.

Routine Maintenance Safe Harbor – Building s/Structural Components
If a taxpayer expects to perform routine maintenance on a building or its structural components more than once over a 10-year period, the cost can be expensed.

Opportunity: Current year maintenance items may be expensed and not required to be capitalized.

Disposition of Tangible Property – Partial Disposition
The Regs allow for a taxpayer to take a loss on the disposal of an asset as well as a component of an asset. For example: If the taxpayer replaces the roof on a building, the taxpayer may write off the undepreciated balance of the first roof as a loss and then begin depreciating the new roof. In the past, the taxpayer had to keep the old roof on the books until it was fully depreciated or the entire building was disposed.

Opportunity: Review your depreciation schedule to write-off the remaining basis of capitalized repairs.

Following are steps for you to follow that will assist you in properly recording costs related to tangible property.

Step 1: Adopt current year De Minimis Policy ($500 or $5,000 for audited financial statements) and attach election to each year's tax return beginning with 2014.

Step 2: Apply De Minimis and safe harbor maintenance rules to materials, supplies, equipment and repairs as follows:

a. Expense supplies and maintenance items lasting < than 12 months,

b. Expense other supplies and maintenance items costing < than $200,
c. Expense repairs and other acquisitions costing < than $500/$5,000 (or amount in company's capitalization policy),
d. Expense items replaced or expected to be replaced more than once during the asset life.

Step 3: Apply safe harbor maintenance rules to buildings:

a. Expense items replaced or expected to be replaced within a 10 year period,
b. Determine if you are a qualified small business with revenues ≤ $10,000,000
c. Determine if building original cost is ≤ $1,000,000
d. If both b and c are met, determine if total maintenance costs are < $10,000 per building.
e. If d is met, expense the amounts. If not, follow the capitalization rules below.

Step 4: Determine the Unit of Property (see paragraph above)

Step 5: Determine if the cost results in a betterment, restoration, or adaption. If so, capitalize the expenditure. If not, expense.

We look forward to discussing these changes with you on an individual basis. Please contact your Widmer Roel professional at your earliest convenience to discuss how the new Regs affect your business and what actions need to be taken to conform to the Regs and what tax savings opportunities are available to your business.

Sincerely,

Widmer Roel PC