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Tangible Property Regulations Effective Tax Year 2014

Background
Historically, regulations have been unclear with interpreting when an expenditure made with respect to tangible property may be deducted as a repair expense or must be capitalized as an improvement and depreciated over time. In an attempt to clarify the rules, the IRS has finalized mandatory regulations, commonly referred to as the "repair regulations", which provide comprehensive standards for distinguishing capital expenditures from deductible repairs and maintenance expenses.

What This Means
The IRS requires taxpayers who acquire, produce, or improve tangible property to "adopt" the final regulations, effective for their first tax year beginning on or after January 1, 2014. The regulations, however, are in effect retroactive and establish new criteria in determining when expenses can be deducted versus capitalized. **This means, in addition to having to apply the rules beginning with tax year 2014, taxpayers must evaluate all previously capitalized expenditures that are still on the books to determine if they should have been expensed under the new regulations.**

The Good News
The new regulations are generally considered to be "taxpayer friendly" from the standpoint of providing guidance for accelerating deductions for certain tangible property expenses under the new criteria and can result in significant benefits in the form of current deductions, resulting in a lower tax burden. The repair regulations also provide for a one-time opportunity, available only in 2014, to make a "late partial disposition election" to treat prior-year retirements of structural components of buildings (such as a replaced roof) as a disposition that generates a deduction in 2014.

Risks of Not Taking Action
Compliance with the new regulations is mandatory! In the event of an IRS audit, keeping improperly capitalized assets on your balance sheet will result in disallowed depreciation deductions for all open tax years, as well as the disallowance of a deduction for the undepreciated amount if the statute of limitations for the year of the expense is closed. Furthermore, in the year the asset is disposed, the IRS will reduce the basis by any improperly capitalized costs, resulting in higher taxable gain.

Action Steps
Compliance for the 2014 tax year generally requires the preparation and filing of one or more automatic requests for accounting method changes with the 2014 tax return. This informs the IRS that you are adopting the new mandatory capitalization rules, will give you audit protection in the event of an IRS examination of these expenditures, and help preserve the appropriate deductions related to these expenditures. Certain elections and safe harbors are also available under the new regulations and should be considered.

It is not too late to take action even if you have already filed your 2014 tax returns. Please contact our office to discuss how the new tangible property regulations affect you and your business.

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