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Sect. 263(a) and the New 2012 Repair Regulations

Adjusting Tax Planning and Compliance for the Latest Cost Capitalization Rules

THURSDAY, FEBRUARY 23, 2012

1pm Eastern | 12pm Central | 11am Mountain | 10am Pacific

Today's faculty features:

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Sect. 263(a) and the New 2012 Repair Regulations Seminar

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Today's Program

The New Proposed And Temporary Regulations
[David Strong and Brian Walsh]

Slide 7 - Slide 45

Critical Compliance Challenges And Tax Planning Structures
[Julia Hall and James Liechty]

Slide 46 - Slide 71

David Strong, Crowe Horwath

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THE NEW PROPOSED AND TEMPORARY REGULATIONS

Background

- Regulations were issued on Dec. 23, 2011.
 - Prior law and guidance
 - Replace proposed regulations issued March 2008
 - Issued as temporary and proposed
 - Are effective for tax years beginning on or after Jan. 1, 2012
 - Provide framework in determining if costs are to be capitalized or deducted

Overview

- Regulations cover four main subject matter areas
 - Materials and supplies
 - Timing of deducting costs
 - Elective capitalization
 - Optional method for rotatable spare parts
 - Acquisition of tangible property
 - What costs must be capitalized ?
 - *De minimis* rule
 - Improvements to tangible property
 - Definition of unit of property, for applying the betterment and restoration standards
 - Guidance regarding betterments, restorations, adaptations of property
 - As part of the restoration rules, illustrations of major component
 - Safe harbor for routine maintenance
 - Dispositions of tangible property
 - Framework for dispositions of components of property
 - Expands use of general asset accounts, for purposes of component dispositions

Materials And Supplies

- General rules
 - Covered under temporary regulation Sect. 1.162-3T and follows current treatment regarding non-incidentals and incidentals materials and supplies
 - Non-incidentals costs are deducted when consumed.
 - Incidentals costs are deducted when incurred.

Materials And Supplies (Cont.)

- Definition of materials and supplies
 - Materials and supplies are defined as tangible property (other than inventory) used or consumed in the taxpayer's operations and that:
 - Are components acquired to maintain, repair or improve a unit of property
 - Consist of fuel, lubricants, water and similar items that are reasonably expected to be consumed within 12 months or less, beginning when the item is consumed
 - Are a unit of property that has an economic useful life of 12 months or less, beginning when the item is used or consumed
 - Are a unit of property that has an acquisition cost of \$100 or less, or
 - Are identified in published guidance issued by the IRS

Materials And Supplies (Cont.)

- Exceptions to general rule
 - *De minimis* rule
 - May elect to include materials and supplies as part of the overall *de minimis* rule
 - Items are included with other property acquired
 - Treatment of labor and overhead costs
 - Only applies when taxpayer has applicable financial statements

Materials And Supplies (Cont.)

- Exceptions to the general rule (Cont.)
 - Rotable and temporary parts
 - Treated as consumed only upon final disposition
 - Optional method allowed
 - Deducted when installed
 - FMV of rotatable spare part is capitalized.
 - Additional costs to maintain, repair or improve the rotatable spare parts are also capitalized to the cost of the part.
 - Deduct costs associated with the part upon re-installation
 - Remaining costs deducted upon disposition

Materials And Supplies (Cont.)

- Example
 - Rotable spare parts – Optional method
 - X has a stock of motors used to repair its machinery when original motors fail. A rotatable motor costs \$5,000 when first purchased. In year 1, one of X's machines breaks down, and X uses one of the motors to replace the damaged part (the old motor is scrapped).
 - X would deduct the \$5,000 in year 1 when the motor was installed in the machine.
 - In year 3, X replaces the rotatable motor with another rotatable motor, deducts the cost of the new motor and capitalizes the FMV of the old motor. Assume the FMV is \$1,000
 - Also in year 3, X incurs \$250 in costs to repair the old motor. Total costs capitalized for the old motor are \$1,250.
 - In year 5, another machine breaks down, and the rotatable motor replaces the damaged part (the damaged motor is scrapped). X would deduct the \$1,250.
 - In year 8, the rotatable motor is disposed of, and any remaining capitalized costs are deducted.

Materials And Supplies (Cont.)

- Exceptions to the general rule (Cont.)
 - Elective capitalization and depreciation
 - May elect to capitalize materials and supplies as fixed assets and depreciate
 - Some exceptions apply.
 - Election is made by capitalizing and depreciating the costs

Costs To Acquire Property

- Rules under temporary regulation Sect. 1.263(a)-2T govern the capitalization of costs incurred to facilitate the acquisition and/or production of real and personal property.
 - Investigating or pursuing a transaction
 - Transaction costs must also be capitalized.
 - Facilitative of the transaction
 - Special rules for acquisition of real property
 - Exception for employee compensation and overhead
 - Inherently facilitative costs

Costs To Acquire Property (Cont.)

- *De minimis* rule
 - Applies to taxpayer that:
 - Has applicable financial statements (AFS)
 - At the beginning of the year, has written accounting procedures for expensing property costing less than a certain dollar amount, for book purposes
 - Expenses *de minimis* amounts on its AFS consistent with those procedures
 - The aggregate amount does not distort income.
 - Ceiling for *de minimis* rule
 - 0.1% of federal income tax gross receipts
 - 2% of depreciation expense (recorded for financial reporting purposes)
 - Unclear on how and when the costs that exceed the ceiling will be capitalized
 - Election to capitalize

Costs To Acquire Property (Cont.)

■ Example

- Application of *de minimis* rule ceiling
- X is a member of an affiliated group that files a consolidated return. In 2012, X purchases 300 computers at \$400 each, for a total cost of \$120,000. X has a written policy at the beginning of the taxable year to expense amounts paid for property costing less than \$500. X treats the amounts paid for the computers as an expense on its applicable financial statement. In addition, in 2012 X purchases 300 desk chairs for \$50 each, for a total cost of \$15,000. X intends to deduct the amounts paid for the desk chairs when incurred under the *de minimis* rule.

For the 2012 taxable year, X has gross receipts of \$125 million and reports \$7 million of depreciation and amortization expense on its applicable financial statement. The overall ceiling for capitalization is the greater of \$125,000 (0.1% of X's total gross receipts of \$125 million) or \$140,000 (2% of X's total depreciation and amortization of \$7 million). Because \$135,000 (\$120,000 + \$15,000) is less than \$140,000, X will not meet the *de minimis* rule ceiling and can deduct the costs in 2012.

Unit Of Property

Personal property

- The 2008 proposed regulations defined the unit of property to include all functionally interdependent components.
- Components are functionally interdependent if placing one component in service depends on placing the other component in service.
- The temporary regulations retain the functional interdependence test as the general rule for determining the unit of property other than buildings.



Unit Of Property (Cont.)

Personal property (Cont.)

Reg § 1.263(a)-3T(e)(6): Amounts paid to improve tangible property (temporary), Example 9

X provides legal services to its clients. X purchased a laptop computer and a printer for its employees to use in providing legal services. When X placed the computer and printer into service, it treated the equipment and all components as being within the same class of property, and depreciated all the components using the same depreciation method. Because the computer and printer are property other than a building, the initial units of property are determined under the general rule and comprise components that are functionally interdependent. The computer and the printer are separate units of property, because they are not components that are functionally interdependent (that is, the placing in service of the computer is not dependent on the placing in service of the printer).



Unit Of Property (Cont.)

Personal property

Reg § 1.263(a)-3T: Amounts paid to improve tangible property (temporary),
Example 8

X owns locomotives that it uses in its railroad business. Each locomotive consists of various components, such as an engine, generators, batteries and trucks. X acquired a locomotive with all its components, all of which it treated as being within the same class of property. It depreciated all the components using the same method. Because X's locomotive is property other than a building, the initial unit of property is determined under the general rule and is composed of components that are functionally interdependent. The locomotive is a single unit of property, because it consists entirely of components that are functionally interdependent.



Unit Of Property (Cont.)

Real property

- The 2008 proposed regulation defined the unit of property for a building as the building and its structural components.
- The temporary regulations retain this rule.
- However, the temporary regulations revise the manner in which the improvement standards must be applied to a building and its structural components.



Unit Of Property (Cont.)

Real property (Cont.)

- The temporary regulations require a taxpayer to apply the improvement standards to the building and specifically defined components of the building, rather than the building and its structural components as a whole.
- The remaining building structure is treated as one unit of property.



Unit Of Property (Cont.)

Real property – Building systems

- HVAC systems
- Plumbing systems
- Electrical systems
- Escalator systems
- Elevator systems
- Fire protection and alarm systems
- Security systems
- Gas distribution systems
- Other structural components as may be identified by future guidance



Unit Of Property (Cont.)

Real property – Building systems (Cont.)

Reg § 1.263(a)-3T(e)(6): Amounts paid to improve tangible property (temporary),
Example 1

X owns an office building that contains a HVAC system. The HVAC system incorporates 10 roof-mounted units that service different parts of the building. Those units are not connected and have separate controls and duct work that distribute the heated or cooled air to different spaces in the building's interior. X pays an amount for labor and materials for work performed on the roof-mounted units. X must treat the building and its structural components as a single unit of property. An amount is paid for an improvement to a building if it results in an improvement to the building structure or any designated building system. The entire HVAC system, including all of the roof-mounted units and their components, comprise a building system. Therefore, if an amount paid by X for work on the roof-mounted units results in an improvement (for example, a betterment) to the HVAC system, X must treat this amount as an improvement to the building.



Unit Of Property (Cont.)

Real property – Leased

- If taxpayer leases an entire building, then the same rules apply as for buildings.
- If the taxpayer leases only a portion of the building, then the rules are applied to that portion of the building leased.



Unit Of Property (Cont.)

Real property – Leased (Cont.)

Reg § 1.263(a)-3T(e)(6): Amounts paid to improve tangible property (temporary),
Example 10

X is a retailer of consumer products. X conducts its retail sales in a building that it leases from Y. The leased building consists of the building structure (including the floor, walls and roof) and various building systems, including plumbing, electrical, HVAC, security, and fire protection and prevention. X pays an amount for labor and materials to perform work on the HVAC system of the leased building. Because X leases the entire building, X must treat the leased building and its structural components as a single unit of property. An amount is paid for an improvement to a leased building if it results in an improvement (for example, a betterment) to the leased building structure or to any building system within the leased building. Therefore, if an amount paid by X for work on the HVAC system results in an improvement to HVAC in the leased building, X must treat this amount as an improvement to the entire leased building.



Improving Tangible Property

Improvements

A unit of property is improved if the amounts paid for activities performed after the property is placed in service by the taxpayer:

- Result in a betterment to the unit of property
- Restore the unit of property, or
- Adapt the unit of property to a new or different use.



Improving Tangible Property (Cont.)

Betterment

- The 2008 proposed regulations provided that an amount paid results in a betterment if the expenditure:
 - Ameliorates a material condition or defect that existed prior to the acquisition of the property (or arose during the production of the property),
 - Results in a material addition to the unit of property (including a physical enlargement, expansion, or extension), or
 - Results in a material increase in the capacity, productivity, efficiency, strength, or quality of the unit of property or its output.
- The temporary regulations retain all of these criteria.



Improving Tangible Property (Cont.)

Betterment (Cont.)

- Conclusions are based on an evaluation of all facts and circumstances.
- Facts-and-circumstances determinations are made by reference to the unit of property's condition immediately before the expenditure being evaluated.



Improving Tangible Property (Cont.)

Betterment (Cont.)

Reg § 1.263(a)-3T(h)(4): Amounts paid to improve tangible property (temporary),
Example 13

X owns a small retail shop. A storm damages the roof of X's shop by displacing numerous wooden shingles. X pays a contractor to replace all the wooden shingles. If the amount paid results in a betterment to the building structure or any building system, X must treat the amount as an improvement to the building. The roof is part of the building structure. The event necessitating the expenditure was the storm. Prior to the storm, the building structure was functioning for its intended use. X is not required to treat the amount paid to replace the shingles as a betterment, because it does not result in a material addition or material increase in the capacity, productivity, efficiency, strength, or quality of the building structure; or in the output of the building structure compared with its condition prior to the storm.



Improving Tangible Property (Cont.)

Betterment (Cont.)

Reg § 1.263(a)-3T(h)(4): Amounts paid to improve tangible property (temporary), Example 14

Assume the same facts as in Example 13 except that wooden shingles are not available on the market. X pays a contractor to replace all the wooden shingles with comparable asphalt shingles. The amount that X pays to re-shingle does not result in a betterment to the shop building structure, even though the asphalt shingles may be stronger than the wooden shingles. Because the wooden shingles could not practicably be replaced with new wooden shingles, their replacement with comparable asphalt shingles does not, by itself, result in a betterment and therefore an improvement.



Improving Tangible Property (Cont.)

Betterment (Cont.)

Reg § 1.263(a)-3T(h)(4): Amounts paid to improve tangible property (temporary), Example 15

Assume the same facts as in Example 14, except that, rather than replace wooden shingles with asphalt shingles, X pays a contractor to replace them with shingles made of lightweight composite materials that are maintenance-free and do not absorb moisture. The new shingles have a 50-year warranty and a Class A fire rating. The amount paid for these shingles results in a betterment to the shop building structure, because it results in a material increase in the quality of structure compared with before the storm. Therefore, X must treat the amount paid for the betterment of the building structure as an improvement to the building and must capitalize the amount paid.



Improving Tangible Property (Cont.)

Restoration

- The 2008 proposed regulations provided that an amount is paid to restore a unit of property if the expenditure:
 - Is for the replacement of a component of a unit of property, and the taxpayer had properly deducted a loss for that component
 - Is for the replacement of a component of a unit of property, and the taxpayer had properly taken into account the adjusted basis of the component in realizing gain or loss from the sale or exchange of the component
 - Is for the repair of damage to a unit of property for which the taxpayer has properly taken a basis adjustment as a result of a casualty loss under § 165



Improving Tangible Property (Cont.)

Restoration (Cont.)

- The 2008 proposed regulations provided that an amount is paid to restore a unit of property if the expenditure (Cont.):
 - Returns the unit of property to its ordinarily efficient operation condition, if the property has deteriorated to a state of disrepair and was no longer functional for its intended use
 - Results in the rebuilding of the unit of property to a like-new condition after the end of its economic useful life
 - Is for the replacement of a major component or a substantial structural part of a unit of property



Improving Tangible Property (Cont.)

Restoration (Cont.)

- The temporary regulations retain in general the framework established by the 2008 proposed regulations.
- The 2008 regulations defined a “major component or substantial structure part” as a part or combination of parts of a unit of property, the cost of which comprises 50% or more of the replacement costs of the unit of property or the replacement of which comprises 50% or more of the physical structure of the unit of property.
- The “50% thresholds” limitation was removed from the temporary regulations.
- Conclusions are based on an evaluation of all facts and circumstances.



Improving Tangible Property (Cont.)

Restoration (Cont.)

Routine maintenance safe harbor

- The 2008 proposed regulations provided a safe harbor for the costs of performing routine maintenance.
- Any amount paid was not deemed an improvement, provided it was for ongoing activities that the taxpayer expected to perform to keep the property in ordinary efficient operating condition.
- The activities were only considered to be routine if at the time the unit of property was placed in service, the taxpayer reasonably expected to perform such activities more than once during the class life of the unit of property.



Improving Tangible Property (Cont.)

Restoration (Cont.)

Routine maintenance safe harbor (Cont.)

- The temporary regulations retain the routine maintenance safe harbor rule, but only for tangible personal property.
- Does not apply buildings and their structural components
- Does not apply is placing in service from a state of disrepair
- Does not apply if the taxpayer has taken a loss or gain on the removal of old components



Improving Tangible Property (Cont.)

Restoration (Cont.)

Plan of rehabilitation doctrine

- The 2008 proposed regulations did not prescribe a plan of rehabilitation doctrine, as has been traditionally described in case law.
- Rather, the 2008 proposed regulations incorporated reference to the § 263A rules for the treatment of such expenditures.
- The temporary regulations retain the rule that references § 263A and make obsolete the judicial plan of rehabilitation doctrine.
- The temporary regulations clarify that all indirect costs, including repairs and maintenance, that are subject to a 263A standard must be capitalized.



Improving Tangible Property (Cont.)

Restoration (Cont.)

Reg § 1.263(a)-3T(i)(5): Amounts paid to improve tangible property (temporary),
Example 12

X owns a large retail store. X discovers a leak in the roof of the store and hires a contractor to inspect and fix the roof. The contractor discovers that a major portion of the sheathing and rafters has rotted, and recommends replacement of the entire roof. X pays the contractor to replace the entire roof. If the amount paid results in a restoration of the building structure or any building system, X must treat the amount as an improvement to the building. The roof is part of the building structure. X must treat the amount paid to replace the roof as a restoration because it paid the amount to replace a major component or substantial structural part of the building structure. Therefore, X must treat the amount paid to restore the building structure as an improvement to the building and must capitalize the amount paid.



Improving Tangible Property (Cont.)

Restoration (Cont.)

Reg. § 1.263(a)-3T(i)(5): Amounts paid to improve tangible property (temporary), Example 13

Assume the same facts as Example 12, except the contractor recommends replacement of a significant portion but not the entire roof. Accordingly, X pays an amount to replace a large portion of the decking, insulation and membrane of the roof of X's retail building. The portion of the roof replaced comprises a major component or substantial structural part of the building structure. Thus, X must treat the amount paid for the roof work as a restoration of the building structure, because it paid the amount to replace a major component or substantial structural part. Therefore, X must treat the amount paid as an improvement to the building and must capitalize the amount paid.



Improving Tangible Property (Cont.)

Restoration (Cont.)

Reg. § 1.263(a)-3T(i)(5): Amounts paid to improve tangible property (temporary), Example 14.

X manufactures parts from a factory. The roof over X's facility is composed of structural elements, insulation, and a waterproof membrane. Over time, the membrane began to wear, and leakage begins. Consequently, X pays an amount to replace the membrane with a similar but new version. If the amount paid results in a restoration of the building structure or any building system, X must treat the amount as an improvement to the building. The roof, including the membrane, is part of the building structure. Although the membrane may affect the function of the building structure, it is not by itself a major component or substantial structural part. Because the roof membrane is not a major component or substantial structural part of the building structure, X is not required to treat the amount paid to replace it as a restoration of the building structure. But, see Sect. 263A and the regulations thereunder for the requirement to capitalize indirect costs that directly benefit or are incurred by reason of production activities.



Dispositions

Dispositions of property subject to § 168

- The temporary regulations revise the definition of disposition so that a taxpayer may treat the retirement of a structural component of a building as a disposition of property.
- This prevents the contemporaneous depreciation of both the retired component and the replacement component that needs to be capitalized under the temporary regulations.



Dispositions (Cont.)

Reg. § 1.168(i)-8T(h): Dispositions of MACRS property (temporary),
Example (5)

D, a calendar-year taxpayer, purchased and placed in service a multi-story office building that costs \$20 million. The cost of each structural component of the building was not separately stated. D accounts for the building in its records as a single. D depreciates the building as non-residential real property and subsequently replaces one of its elevators. Because D cannot identify the cost of the structural components of the office building from its records, it uses a reasonable method that is consistently applied to all of the structural components to determine the cost of the elevator. Using this reasonable method, D allocates a portion of the purchase price for the building to the retired elevator and determines the depreciation allowed or allowable for the retired elevator. D can then determine the loss allowed for the retired elevator.



Effective Dates

- The temporary regulations apply to all tax years beginning on or after Jan. 1, 2012, or where applicable to amounts paid or incurred in taxable years beginning on or after Jan. 1, 2012.



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CRITICAL COMPLIANCE CHALLENGES AND TAX PLANNING STRUCTURES

Unit Of Property

- Buildings and structural components
 - Defined §1.48-1(e)(1) and (2)
 - Single unit of property
 - Improvement is **not** a separate UOP.
 - Depreciation classification

Unit of Property (Cont.)

- Building systems
 - **Separate** from building structure UOP
 - Smaller UOP results in more capitalized costs.
 - HVAC systems
 - Plumbing systems
 - Electrical systems

Unit Of Property (Cont.)

- Building systems (Cont.)
 - Escalators
 - Elevators
 - Fire protection and alarm systems
 - Security systems
 - Gas distribution systems
 - Any other system in published guidance

Unit Of Property (Cont.)

- Property other than building
 - All functionally interdependent components are single UOP.
- Leased property
 - Portion of building leased
 - Lessee improvement separate UOP

Dispositions

- General rule
 - Loss on disposal of asset or component of asset
- General asset account election
 - No loss on disposal
 - Election for qualifying disposition to recover basis
- Depreciation ends where loss is claimed on disposal
- Interaction of restoration and disposition rules
- Asset classes 00.11 to 00.4

Dispositions (Cont.)

- Identification of asset disposed of
 - Facts and circumstances
 - Cannot be larger than the UOP
 - Each structural component of a building
 - Specific identification
 - First in, first out (FIFO)
 - Modified FIFO
 - Mortality dispersion table
 - Last in, first out (LIFO) is specifically not permitted.

Dispositions (Cont.)

- Determination of basis
 - May use any reasonable, consistent method to determine basis
 - Difficulty identifying the basis of major building systems or components
- Considerations
 - Benefit as part of Sect. 481(a) adjustment
 - Computer system requirements going forward

Depreciation

- Single asset account
- Multiple asset account
- Mass asset account
- **General asset account**
 - Annual election
- Impact on repair additional rules for property other than buildings

Materials And Supplies

- Elect to treat as a *de minimis* cost
- Limited application of \$100 rule
- Identification of economic life of 12 months or less
 - Favorable to begin 12-month period with use
- Identification of non-incidental materials and supplies
 - No record of consumption or physical inventory

Materials And Supplies (Cont.)

- Rotable spare parts
 - Impact on prior guidance
 - Optional method
 - Acquired or produced as part of a single piece of property
 - Not a rotatable when removed
 - See Sect. 1.162-3T(h), Example 4

De Minimis Rule

- Taxpayers without an applicable financial statement
 - \$100 material and supply rule adequate?
- No book/tax conformity
- Over ceiling
 - Identification property
 - Elect to capitalize excess?
- Preamble comments on clear reflection of income
- Interaction with materials and supplies

Betterment - Material

- Ameliorates **material** condition or material defect that existed prior to acquisition or arose during production
- **Material** addition (including enlargement, expansion, or extension),
OR
- **Material** increase in capacity, productivity, efficiency, strength, or quality of UOP or output

Betterment

- Refresh and remodel
- Examples in regs
- Retrofitting
- Facts and circumstances

Restoration

- Defined in §1.263(a)-3T(i) – amount paid to restore a UOP only if it:
 - Replaces component of UOP that taxpayer has properly deducted loss for that component (other than casualty loss under §1.165-7 or used adjusted basis of the component in realizing gain or loss from sale or exchange)
 - Repairs damage to UOP when taxpayer properly taken a basis adjustment as result of casualty loss in §165

Restoration (Cont.)

- Returns UOP to ordinarily efficient operating condition, if deteriorated to disrepair and no longer functional for intended use
- Rebuilding UOP to like-new condition after end of class life under §168 ADS purposes
- Replace parts or combination of parts that comprise major component or substantial structural part of UOP
 - Facts and circumstances

Routine Maintenance Safe Harbor

- Does not apply to buildings
- Deductible – not improving UOP
- Recurring activities expected to be performed as result of use of UOP to keep in ordinarily efficient operating condition
- Only if, when placed in service, expected to be performed more than once during class life

Routine Maintenance Safe Harbor (Cont.)

- Examples: Inspection, cleaning, testing, replacement of parts of UOP with comparable items
- Factors
 - Recurring nature of the activity
 - Industry practice
 - Manufacturers' recommendations
 - Taxpayer's experience
 - Taxpayer's treatment on its applicable financial statements

Adapt

- New or different use: Not consistent with intended ordinary use of property when placed in service
- Example: Owner of a building consisting of 20 retail spaces converts three spaces into one larger space for an existing tenant, by knocking down walls. Cost is not treated as a new or different use, since it is consistent with the owner's intended, ordinary use of the building. Reg. §1.263(a)-3T(j)(4), Example 2

Acquisition Costs – Real Property

- Capitalize amounts to facilitate the acquisition of real or personal property – paid in the process of investigating or otherwise pursuing acquisition
- Facts and circumstances.
- Inherently facilitative
- Real property “whether and which”
- Allocation of transaction costs between real and personal property, when both acquired as part of single transaction

Industry Issue Resolutions

- Regs do not alter previous guidance
 - Electric utility transmission
 - Wireless telecommunication
 - Track maintenance for railroads

Transition Rules

- Automatic method change
 - Two revenue procedures are to be issued “soon.”
- Sect. 481 adjustment/cut-off?
- Audit protection?
- Scope limitations?
- Impact on prior
 - Exams?
 - Closing agreements/or other agreements reached on exam?
 - Different treatment for *de minimis* costs for the acquisition of property?
- Statistical sampling
 - Extrapolation

Paid Or Incurred Exceptions

Portions of the temporary regulations applicable to amounts paid or incurred in taxable years beginning on or after Jan. 1, 2012:

1. Materials and supplies (Treas. Reg. §1.162-3T)
2. The special rule for costs related to the acquisition of real property (Treas. Reg. §1.263(a)-2T(f)(2)(iii))
3. Employee compensation and overhead costs related to the acquisition or production of property (Treas. Reg. §1.263(a)-2T(f)(2)(iv))
4. The treatment of inherently facilitative amounts related to the acquisition or production of property (Treas. Reg. §1.263(a)-2T(f)(3)(ii))
5. The *de minimis* rule or “capitalization threshold” related to the acquisition or production of property (Treas. Reg. §1.263(a)-2T(g))

Paid Or Incurred Exceptions (Cont.)

Portions of the temporary regulations applicable to amounts paid or incurred in taxable years beginning on or after Jan. 1, 2012 (Cont.):

6. Production costs of property subject to the acquisition of property *de minimis rule* or capitalization threshold (Treas. Reg. §1.263A-1T(b)(14))
7. The recovery of costs capitalized under Sect. 263A (Treas. Reg. §1.263A-1T(c)(4))
8. Sect. 263A direct material costs (Treas. Reg. §1.263A-1T(e)(2)(i)(A))
9. Sect. 263A indirect material costs (Treas. Reg. §1.263A-1T(e)(2)(ii)(E))
10. Changes in method of accounting for costs subject to the *de minimis rule* or capitalization threshold (Treas. Reg. §1.263A-1T(l))

Transition Rules

- In general, a method change with a full Sect. 481(a) adjustment is required to implement changes resulting from the new regulations.
 - Sect. 481(a) adjustment prevents duplication or omission of amounts upon a change from old to new method, and is computed notwithstanding the period of limitations.
- However, the items noted above, e.g., materials and supplies and the *de minimis* rule, require a cut-off adjustment.
 - Under the cut-off method, items in year of s change and future years are determined under the new method, and items for prior years continue to be determined under the old method.

General Considerations

- Application of a general legal frame work to facts and circumstances
 - Many examples
 - Industry Issue Resolution
 - CAP taxpayers
 - Pre-filing agreement
- Many elections are only revocable by requesting a private letter ruling and demonstrating “good cause.”
- Book/tax conformity?