

## Repair Regulations: *De Minimis* Expensing Rule

New “repair” regulations, applicable to repairs and improvements to tangible property, apply to tax years beginning on or after January 1, 2014, but may be applied to tax years beginning on or after January 1, 2012, at the taxpayer’s election. The *de minimis* expensing rule is one of the most important provisions of the temporary repair regulations. Previously, an expensing policy was not governed by any specific rules or requirements other than that the policy not materially distort income. Going forward, a taxpayer will need to comply with strict regulatory requirements in order to take advantage of an expensing policy.

### In General

The *de minimis* rule allows a taxpayer to deduct certain amounts paid or incurred to acquire or produce a unit of tangible property if the taxpayer has an applicable financial statement, has written accounting procedures for expensing amounts paid or incurred for such property under certain dollar amounts, and treats such amounts as expenses on its applicable financial statement in accordance with its written accounting procedures. An overall ceiling limits the total expenses that a taxpayer may deduct under the rule. The *de minimis* expensing rule applies to amounts paid or incurred to acquire or produce property in tax years beginning on or after January 1, 2014, or at a taxpayer's option, to amounts paid or incurred to acquire or produce property in tax years beginning on or after January 1, 2012.

Many small businesses do not have applicable financial statements and will not be able to use the *de minimis* rule unless the IRS approves additional types of financial statements in the final regulations. These taxpayers will be limited to expensing amounts that qualify under [Code Sec. 179](#). There is an expectation that the IRS will relax the rules requiring an applicable financial statement in the final regulations.

If property expensed under the *de minimis* rule is sold or disposed of, the amount recognized is ordinary income. The property is not treated as a capital asset or as property used in a trade or business under [Code Sec. 1231](#).

### When The Rule Applies

With the exception of materials and supplies for which the *de minimis* rule is elected, the *de minimis* rule applies to amounts that must otherwise be capitalized because the amount was paid to acquire or produce a unit of real or personal property. Amounts paid to acquire or produce a unit of property include the invoice price, certain transactions costs such as transportation costs, and costs for work performed prior to the date the unit of property was placed in service, such as installation, critical testing, and repair costs. [Temp. Reg. §1.263\(a\)-2T\(d\)](#). Amounts paid for property intended for use in inventory may not be deducted under the *de minimis* rule.

The *de minimis* rule applies if all of the following apply:

- The taxpayer has an applicable financial statement.
- The taxpayer has, at the beginning of the tax year, written accounting procedures treating as an expense for non-tax purposes the amounts paid or incurred for property costing less than a certain dollar amount.
- The taxpayer treats the amounts paid or incurred during the tax year as an expense on its applicable financial statement in accordance with its written accounting procedures.
- The total aggregate of amounts paid or incurred and not capitalized under the *de minimis* rule (including materials and supplies for which an election is made to apply the *de minimis* rule) are less than or equal to the greater of: (a) 0.1 percent of the taxpayer's gross receipts for the tax year as determined for federal income tax purposes; or (b) two percent of the taxpayer's total depreciation and amortization expense for the tax year as determined in its applicable financial statement.

#### Comment

The preamble to the regulations ([T.D. 9564](#)) indicates that the cap may be increased if an examining agent agrees that the increase is not material. Thus, it appears that taxpayers with an expensing policy previously approved in an audit may continue to expense amounts in excess of the cap so long it does not result in a material distortion of income.

#### Example

YAZ purchases 10 printers at \$200 each for a total cost of \$2,000. Each printer is a unit of property and is not a material or supply. YAZ has an applicable financial statement and a written policy at the beginning of the tax year to expense amounts paid for property costing less than \$500. YAZ treats the amounts paid for the printers as an expense on its applicable financial statement. Assume that the total aggregate amount treated as *de minimis* and not capitalized, including the amounts paid for the printers, are less than or equal to the greater of 0.1 percent of total gross receipts or two percent of YAZ's total financial statement depreciation. The *de minimis* rule applies and YAZ is not required to capitalize the amounts paid for the 10 printers ([Temp. Reg. §1.263\(a\)-2T\(g\)\(8\)](#), Ex. 1).

Amounts expensed under the *de minimis* rule are not required to be capitalized under the uniform capitalization rules of [Code Sec. 263A](#) to a separate unit of property, but may be required to be capitalized under [Code Sec. 263A](#) as part of the cost of other property if incurred by reason of the production of the other property. For example, taxpayers are required to capitalize under [Code Sec. 263A](#) the cost of tools and equipment allocable to property produced or property acquired for resale.

## Comment

The IRS has indicated that if a taxpayer inadvertently deducts more than the amount allowed under the *de minimis* rule, only the excess amount will be disallowed as a current deduction. The final regulations should clarify this point.

The *de minimis* rule is not elective. However, a taxpayer may elect to capitalize amounts that would otherwise be subject to the *de minimis* rule. The election is simply made by capitalizing the amounts paid or incurred to acquire or produce the unit of property in the tax year the cost is paid or incurred. A taxpayer should capitalize amounts that would be deductible under the *de minimis* rule but for the ceiling.

## Caution

Taxpayers that did not have a written policy of expensing *de minimis* amounts in effect on January 1, 2012 (or the first day of their 2012 tax year) may not use the *de minimis* rule during 2012. Because the temporary regulations were issued in December 2011, some taxpayers had insufficient time to put a written policy in effect. Commentators have asked for transitional relief from this requirement.

Materials and supplies are subject to the *de minimis* rule to the extent that a taxpayer elects to treat them as subject to the rule. [Temp. Reg. §1.162-3T\(f\)](#). Incidental materials and supplies are deducted in the tax year that their cost is paid or incurred. Consequently, there is no reason to elect to apply the *de minimis* rule to these materials and supplies. Non-incidental materials and supplies are deducted when used or consumed. The *de minimis* rule is beneficial for non-incidental materials and supplies that would be used or consumed in a tax year after their cost is paid or acquired.

## Applicable Financial Statement

An applicable financial statement for purposes of qualifying for the *de minimis* rule only includes:

- a financial statement required to be filed with the Securities and Exchange Commission (the 10-K or the Annual Statement to Shareholders);
- a certified audited financial statement that is accompanied by the report of an independent CPA (or in the case of a foreign entity, by the report of a similarly qualified independent professional) that is used for (1) credit purposes, (2) reporting to shareholders, partners, or similar persons, or (3) any other substantial non-tax purpose; or
- a financial statement (other than a tax return) required to be provided to the federal or a state government or any federal or state agency (other than the SEC or the IRS).

## **Accounting Method Change**

An automatic change in accounting method procedure may be used to adopt the *de minimis* expensing method for taxpayers choosing to apply the *de minimis* rule as contained in the temporary regulations to tax years beginning on or after January 1, 2012, and before the effective date of the final regulations. The change is applied on a cut-off basis.