



Addendum: 2013 The Essential 1040

Revision 1.0

Updating text information based on the new final repair and capitalization regulations [T.D. 9636].

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[Old] In an effort to clarify the capitalization rules, the repair versus improvement rules and cost associated with acquisition and disposition, the IRS in 2011, issued temporary regulations (T.D. 9564) on capitalizing costs of acquiring, producing and improving tangible property, that were originally schedule to apply on or after January 1, 2012. These have since been amended to apply to tax years beginning on or after January 1, 2014. At the taxpayer's option, he or she can apply the temporary regulations to tax years beginning on or after January 1, 2012.

[New] In an effort to clarify the capitalization rules, the repair versus improvement rules and cost associated with acquisition and disposition, the IRS in 2013, issued final regulations (T.D. 9636) on capitalizing costs of acquiring, producing and improving tangible property, that were originally schedule to apply on or after January 1, 2012. The final regulations must be followed by all taxpayers for tax years beginning on or after January 1, 2014. At the taxpayer's option, he or she can apply the final or former temporary regulations to tax years beginning on or after January 1, 2012.

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[Old] The de minimis rule provides that a business can deduct the expense of relatively low-cost items even if the general rule requires capitalization. To use the de minimis exception:

- The taxpayer must have an applicable financial statement as defined in Reg. §1.263(a)-2T(g)(6) for the taxable year.
- The taxpayer has at the beginning of the year written accounting procedures treating as an expense for nontax purposes the amounts paid for property that cost less than a specific dollar amount.
- The taxpayer treats such amounts paid as a expense on its applicable financial statement in accordance with its written accounting procedures.
- The total aggregate amounts paid and not capitalized under the de minimis rule does not exceed the greater of the following amounts.
 - 0.1% of the taxpayer's gross receipts for the year.
 - 2.0% of the taxpayer's total depreciation and amortization expense for the year.



Units of property to which the de minimis rules apply are not materials or supplies subject to special rules. However, a taxpayer can elect to apply the de minimis rules to particular items of materials or supplies.

[New] The de minimis rule provides that a business can deduct the expense of relatively low-cost items even if the general rule requires capitalization.

If the taxpayer has an applicable financial statement, has written accounting procedures for expensing amounts paid for property and treats the amounts as expenses on its applicable financial statement, the taxpayer can deduct up to \$5,000 of the cost of an item of property per invoice or per item.

If the taxpayer does not have an applicable financial statement the taxpayer can elect the de minimis safe harbor and expense up to \$500 per invoice or per item.

The final regulations provide that this is a safe harbor that is elected annually by including a statement with the return. The election applies to all qualified expenses, including materials and supplies that meet the requirements.

The safe harbor also extends to property with an estimated useful life of 12 months or less if the taxpayer's accounting procedures in place at the beginning of the year allow for deducting these amounts, and the cost of each item does not exceed the \$5,000 or \$500 threshold.

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The example is replaced with another example from the regulations – Reg. §1.263(a)-1(f)(7), Example 9.

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Added after the first paragraph under Improving Property:

The temporary regulations did not provide a separate rule for the treatment of removal costs. The final regulations clarify that the cost of removing a depreciable asset or component is not capitalized as part of the improvement if a gain or loss is realized on the removed asset or component. If the taxpayer does not realize a gain or loss on disposing of the property, then the cost of removal is deducted if the removal costs directly benefit or are incurred by reason of a repair to the property. Otherwise, the removal costs are capitalized as part of the improvement.



The final regulations provide a new building safe harbor for small taxpayers with average annual gross receipts of \$10 million or less during the three preceding tax years. The final regulations include an annual safe harbor election for a taxpayer for building owned or leased with an unadjusted basis no greater than \$1 million. The taxpayer is not required to capitalize improvements if the total amount paid for repairs, maintenance, and improvements does not exceed the lesser of \$10,000 or 2% of the unadjusted basis of the building. Amounts deducted under the de minimis rule or the new safe harbor rule for routine maintenance count towards the \$10,000 limit. This safe harbor applies separately to each building owned by the taxpayer.

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The last two tests under Betterment have been revised by eliminating the “results in” provision. These have been revised to include an expenditure if it:

- Is for a material addition, including a physical enlargement, expansion, extension, or addition of a major component, to the unit of property or a material increase in capacity, including additional cubic feet or linear space, or the unit of property.
- Is reasonably expected to materially increase the productivity, efficiency, strength, quality, or output of the unit of property.

The reference in the example is changed to Reg. §1.263(a)-3(j)(3), Example 1.

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Reference to the first example is changed to Reg. §1.263(a)-3(j)(3), Example 2.

Reference to the first example is changed to Reg. §1.263(a)-3(j)(3), Example 10.

Page 141[New] Before Note box.

The final regulations revise the casualty loss rule to allow a deduction for amounts spent in excess of the adjusted basis of the property damaged in a casualty event. The taxpayer is still required to capitalize amounts paid to restore damage to property for which the taxpayer has properly recorded a basis adjustment, but the costs required to be capitalized under the casualty loss rule are limited to the excess of the taxpayer's basis adjustments resulting from the casualty event over the amount paid for restoration of damage to the unit of property that are otherwise considered capitalizable restorations. Casualty-related expenditures in excess of this limitation can be deducted as repair expenses.

Example reference changed to Reg. §1.263(a)-3(l)(3), Example 1.

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[last bullet] Is a unit of property that has an acquisition cost or production cost of \$200 or less (or other amount as identified in published guidance in the Federal Register or in the Internal Revenue Bulletin.



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[New] Standby emergency spare parts are parts acquired for a particular machine and set aside to avoid substantial operational time loss. Standby spare parts are usually expensive, and they are not subject to periodic replacement, acquired in quantity, repaired or reused.

Under the final regulations, only rotatable, temporary or standby emergency spare parts qualify for the election to capitalize and depreciate as a separate asset amounts paid for materials and supplies used to repair or improve a unit of property.

The procedure to revoke an election to capitalize and depreciate materials and supplies is also clarified: the taxpayer must file a request for a private ruling to obtain IRS consent.

Page 146 [New]

Routine Maintenance

Under the routine maintenance safe harbor, amounts paid are deductible if it is for recurring activities the taxpayer expects to perform to keep the unit of property in its ordinarily efficient operating condition.

The activity is routine if the taxpayer expects to perform the activity more than once during the class life of the unit of property.

The final regulations expand the routine maintenance safe harbor to allow expensing for routine maintenance activities on a building and its structural components. The taxpayer must reasonably expect to perform such maintenance more than once over a 10-year period.

The routine maintenance safe harbor does not apply to amounts paid for repairs, for maintenance, and for improvements to network assets such as railroad track, oil or gas pipeline, water or sewage pipeline, power transmission and distribution lines, and telephone and cable lines.

New Election to Capitalize Repair and Maintenance Costs

The final regulations allow taxpayers to make an annual election to opt out of expensing repair and maintenance costs if the taxpayer treats the costs as capital expenditures on its books and records. The taxpayer must elect to capitalize these expenses on its return. An electing taxpayer must also depreciate the expenditure.

The election applies to all amounts paid for repair and maintenance to tangible property that the taxpayer treats as capital expenditures on its books and records for the tax year, but does not apply to amounts paid for repair or maintenance of rotatable or temporary spare parts that are subject to the elective optional method of accounting for them.

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Revision 1.1

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[Old] Net investment income includes gross income from:

[New] Net investment income includes gross income from the following sources reduced by deductions that are properly allocable to that gross income or gain.

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[Old] Form 8829, *Expenses For Business Use of Your Home*, is not used for the simplified safe harbor method. The square footage is entered directly on Form 1040, Line 30, and then a worksheet in the Form 1040 instructions is completed to compute the deduction.

[New] Form 8829, *Expenses For Business Use of Your Home*, is not used for the simplified safe harbor method. The square footage is entered directly on Schedule C (Form 1040), Line 30, and then a worksheet in the Schedule C instructions is completed to compute the deduction.

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