

TAX PRACTICE CORNER

The de minimis safe harbor under the repair regulations

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Among the more welcome changes adopted in the final tangible property repair regulations (T.D. 9636) is the *de minimis* rule related to the acquisition or production of property (Regs. Sec. 1.263(a)-1(f)). This rule provides for a safe harbor applied at the invoice or item level, based on the policies used by a taxpayer for its financial accounting books and records.

A taxpayer is generally required to capitalize amounts paid to acquire or produce a unit of real or personal property. However, under the *de minimis* rule, a taxpayer may elect to expense the cost of acquired or produced tangible personal property that does not exceed a certain dollar amount per invoice or item. For taxpayers with an applicable financial statement, the amount paid for property may not exceed \$5,000; for those without an applicable financial statement, the amount may not exceed \$500. An applicable financial statement is a financial statement: (1) filed with the SEC (Form 10-K), a certified audited financial statement used for credit purposes, for reporting to shareholders or partners, or any other substantial nontax purpose; or (2) a financial statement (other than a tax return) required to be provided to a federal or state government or agency (other than the SEC or IRS).

The *de minimis* threshold is applied at the invoice level or, if multiple items appear on a single invoice, at the item level. Additional costs, such as delivery or installation fees, that appear on the same invoice as the property must be included in the property's cost. If these additional costs are not included on the same invoice as the property, the taxpayer may, but is not required to, include the additional costs in the property's cost. When multiple items of property are purchased on one invoice and additional costs are stated as a single sum, the taxpayer must use a reasonable method to allocate the additional costs among each item of property in computing the per-item cost (Regs. Sec. 1.263(a)-1(f)(3)(i)).

For example, assume a taxpayer with an applicable financial statement purchases 10 computers at \$5,000 each and receives an invoice for \$51,000, which includes a delivery fee of \$1,000. Pro rata allocation of the delivery fee brings the cost of each computer to \$5,100, which exceeds \$5,000; therefore, the taxpayer may not apply the safe harbor to expense its cost. However, had the delivery fee legitimately appeared on a separate invoice (e.g., an invoice from the freight company instead of the seller), the taxpayer could apply the safe harbor and deduct the cost of the computers, as well as the delivery fee.

An anti-abuse rule (Regs. Sec. 1.263(a)-1(f)(6)) prohibits a taxpayer from manipulating a transaction to avoid the applicable per-item limit. Thus, a taxpayer cannot separate the cost of a machine into two components (such as a motor and its housing) on two invoices to avoid the dollar limit.

The safe harbor generally must be applied to all qualifying tangible property, including eligible materials and supplies. Under the general rule for materials and supplies, nonincidental materials and supplies are deducted as used, and incidental materials and supplies for which no consumption or inventory records are maintained are deducted when paid (Regs. Sec. 1.162-3(a)). However, if the taxpayer elects to apply the *de minimis* safe harbor, some nonincidental materials and supplies may be deducted when purchased, rather than in the year they are used, as under the general rule. Only if the taxpayer defers deducting those items until used for financial accounting purposes will the *de minimis* safe harbor not apply and the deduction be deferred for tax purposes.

The safe harbor does not apply to materials and supplies acquired for use in manufacturing inventory if capitalization

is otherwise required under Sec. 263A. It also does not apply to amounts paid for inventory and land, or the cost of rotable, temporary, or emergency spare parts when the taxpayer elects to capitalize and depreciate these, or to rotable or temporary spare parts accounted for under the optional method of Regs. Sec. 1.162-3(e).

To take advantage of the *de minimis* rule, a taxpayer must have written accounting procedures in place at the start of the tax year treating amounts paid for property costing less than a certain dollar amount (e.g., \$5,000 with an applicable financial statement or \$500 without) or items having an economic useful life of 12 months or less as expenses for financial accounting purposes. The taxpayer also must elect the safe harbor annually.

The election may not be revoked or made through filing an application for change in accounting method. It is made by attaching a statement to a timely filed original tax return (including extensions) for the year in which the amounts are paid. The statement should include the taxpayer's name, address, taxpayer identification number, and a statement that the taxpayer is making the *de minimis* safe-harbor election under Regs. Sec. 1.263(a) 1(f). For a consolidated group, the common parent makes the election for each member, and the election is made at the entity level for an S corporation or a partnership.

Prior *JofA* coverage of the final tangible property regulations includes "Implementing the New Tangible Property Regulations," Feb. 2014, page 22, and "Tax Practice Corner: Automatic Consent for Changing Accounting Methods Under the 'Repair Regs.," April 2014, page 58.

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