Repair Regulations
Restorations

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IOWA STATE UNIVERSITY
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Definitions

- Unit of Property
- Functional Interdependent

Unit of Property

- All the components of property that are functionally interdependent
  - Functional interdependence occurs if a component cannot be placed in service without another component
- Special rules apply for determining the unit of property for buildings, plant property, and network assets
- Special rules for determining the units of property for condominiums, cooperatives, and leased property, and for the treatment of improvements (including leasehold improvements)
- The regulations generally defined a building as a unit of property, but required the **application of the improvement standards** to the building structure and the building systems

Unit of Property

- The UOP serves as the measure of a piece of property
- Guidance concerns how a UOP may be:
  - Acquired
  - Placed in service
  - Repaired, or
  - Improved – application of the improvement standards
- UOP rules apply only for:
  - Capital expenditures,
  - Materials and supplies, and
  - Amounts paid to acquire, produce, or improve tangible property

Unit of Property

- The unit-of-property must be identified before determining whether an expenditure can be deducted or must be capitalized
- Generally, an expenditure must be capitalized if it improves a unit-of-property
- An expenditure improves a unit-of-property if the amount paid results in a betterment, restoration, or an adaptation to a new or different use (the "improvement standards")

Exception to “functionally interdependent” Standard

- In certain situations, a component may be treated as a separate UOP at the time it is placed in service
- A client may properly treat the component as a different class of property from the larger UOP for MACRS depreciation purposes
- A client may also properly depreciate the component using a different depreciation method from the larger UOP
- Finally, a client may change the treatment of a component in any later year to its proper MACRS class or depreciation method

Exception to "functionally interdependent" Standard

- The reclassified portion of the UOP is treated as a separate UOP for capitalization purposes
- For example, a client may classify the tires of a tractor as a separate asset for depreciation purposes
- Thus a client who makes an improvement to the differently-classed tires would only need to capitalize the improvement costs to the tires, not the UOP of the truck

Requirement to Capitalize Amounts Paid for Improvements

- A client generally must capitalize the amounts paid to improve a unit of property, but
- Review § 263A for the requirement to capitalize the direct and allocable indirect costs of property produced by the client and property acquired for resale
- Review § 1016 for adding capitalized amounts to the basis of the unit of property
- Review § 168 for the treatment of additions or improvements for depreciation purposes
- For purposes of this section, a unit of property is improved if the amounts paid for activities performed after the property is placed in service by the taxpayer—
  - (1) Are for a betterment to the unit of property
  - (2) Restore the unit of property; or
  - (3) Adapt the unit of property to a new or different use

Exemptions

- Though the "functionally interdependent" applies to both real and personal property, the regulations carve out exemptions for many categories of property
- They include:
  - Buildings, including condominiums, cooperatives, and leased buildings;
  - Plant property;
  - Network assets;
  - Leased property;
  - Improvements to property;
  - Property and property components with different MACRS classes or depreciation methods; and
  - Property aggregated into asset

Buildings

- The "functionally interdependent" standard does not apply to buildings and building systems
- Generally, the regulations define a building's UOP as the building itself and its structural components
- Structural components of a building include walls, partitions, floors, ceilings, and permanent coverings
- The regulations also create a separate class of structural components – building systems

Nine Separate Building Systems

- Heating, ventilation, and air conditioning (HVAC) systems;
- Plumbing systems;
- Electrical systems;
- All escalators;
- All elevators;
- Fire-protection and alarm systems;
- Security systems;
- Gas distribution systems; and
- Other systems specifically designated in the Federal Register or Internal Revenue Bulletins

Restorations

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Restorations

- A taxpayer must capitalize as an improvement an amount paid to restore a unit of property, including an amount paid to make good the exhaustion for which an allowance is or has been made

What is Restoring a Unit of Property?

- A replacement of a component of a unit of property for which the taxpayer has properly deducted a loss for that component, other than a casualty loss
- A replacement of a component of a unit of property for which the taxpayer has properly taken into account the adjusted basis of the component in realizing gain or loss resulting from the sale or exchange of the component
- A restoration of damage to a unit of property for which the taxpayer is required to take a basis adjustment as a result of a casualty loss, or related to a casualty event

What is Restoring a Unit of Property?

- Returns the unit of property to its ordinarily efficient operating condition if the property has deteriorated to a state of disrepair and is 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 class life
- Is for the replacement of a part or a combination of parts that comprise a major component or a substantial structural part of a unit of property

Application of Restorations to Buildings

- An amount is paid to improve a building if it is paid to restore a property
  - Building
  - Condominium
  - Cooperative
  - Leased building or portion of building
- An amount is paid to improve a building if it is paid for the replacement of :
  - Part or combination of parts
  - Major component or substantial structural part of the building structure or
  - Any one of its building systems

Exception for Losses Based on Salvage Value

- A taxpayer is not required to treat as a restoration amounts paid
  - If the unit of property has been fully depreciated and
  - The loss is attributable only to remaining salvage value as computed for federal income tax purposes

Restoration of Damage from Casualty

- The amount paid for restoration of damage to the unit of property that must be capitalized is limited to the excess (if any) of—
  - (A) The amount of the adjusted basis of the single, identifiable property for determining the loss allowable on account of the casualty, over
  - (B) The amount paid for restoration of damage to the unit of property of this section that also constitutes an improvement

Rebuild to Like-New Condition

- A unit of property is rebuilt to a like-new condition if it is brought to the status of :
- New
- Rebuilt
- Remanufactured, or
- A similar status
- Generally, a comprehensive maintenance program, even though substantial, does not return a unit of property to a like-new condition

Replacement of a Major Component or a Substantial Structural Part

- To determine whether an amount is for:
  - The replacement of a part or
  - A combination of parts
  - That together comprise a major component or a substantial structural part of the unit of property
- Must consider all the facts and circumstances

Major component.

- A major component:
  - A part or combination of parts that performs a discrete and critical function in the operation of the unit of property
- An incidental component :
  - Even though the component performs a discrete and critical function in the operation of the unit of property, generally will not, by itself, constitute a major component

Substantial structural part.

- A substantial structural part is a part or combination of parts that comprises a large portion of the physical structure of the unit of property

Major components and substantial structural parts of buildings.

- In the case of a building:
- An amount is for the replacement of a major component or a substantial structural part of the building unit of property if :
  - (A) The replacement includes a part or combination of parts that comprise a major component, or a significant portion of a major component or
  - (B) The replacement includes a part or combination of parts that comprises a large portion of the physical structure of any of the properties

Replacement of Loss Component

- Andrew owns a manufacturing building containing various types of manufacturing equipment
- He determines that a walk-in freezer in the manufacturing building is section 1245 property
- The freezer is not part of the building structure or the HVAC system
- Several components of the walk-in freezer cease to function, and he decides to replace them
- Andrew abandons the old freezer components and properly recognizes a loss from the abandonment of the components
- He replaces the abandoned freezer components with new components
- He must capitalize the amounts paid to acquire and install the new freezer components because he replaced components for which it had properly deducted a loss

Replacement of Sold Component

- Let's say Andrew A did not abandon the components but instead sold them to another party and recognized a loss on the sale
- Andrew must capitalize the amounts paid to acquire and install the new freezer components
- He replaced components for which he had taken into account the adjusted basis of the components in realizing a loss from the sale of the components

Restoration after Casualty Loss

- Betty owns an office building that it uses in its trade or business
- A storm damages the office building at a time when the building has an adjusted basis of $500,000
- Betty deducts a casualty loss in the amount of $50,000, and properly reduces its basis in the office building to $450,000
- She then hires a contractor to repair the damage to the building, including the repair of the building roof and the removal of debris from the building premises paying the contractor $50,000 for the work

Restoration after Casualty Loss

- Betty must treat the $50,000 amount paid to the contractor as a restoration of the building structure
- Betty properly adjusted its basis in that amount as a result of a casualty loss
- Betty must treat the amount paid as an improvement to the building unit of property andmust capitalize the amount paid

Restoration after Casualty Event

- Let's say Betty receives insurance proceeds of $50,000 after the casualty to compensate for its loss
- She cannot deduct a casualty loss because its loss was compensated by insurance
- However, Betty properly reduces its basis in the property by the amount of the insurance proceeds
- She must treat the $50,000 amount paid to the contractor as a restoration of the building structure because she properly took a basis adjustment relating to a casualty event
- Betty must treat the amount paid as an improvement to the building unit of property and must capitalize the amount paid

Restoration after Casualty Loss: Limitation

- Cindy owns a building that it uses in its trade or business
- A storm damages the building at a time when the building has an adjusted basis of $500,000
- She determines that the cost of restoring its property is $750,000
- She deducts a casualty loss in the amount of $500,000, and properly reduces its basis in the building to $0
- Cindy then hires a contractor to repair the damage to the building and pays the contractor $750,000 for the work

Restoration after Casualty Loss: Limitation

- The work involves replacing the entire roof structure of the building at a cost of $350,000
- Pumping water from the building
- Cleaning debris from the interior and exterior
- Replacing areas of damaged dry wall and
- Flooring at a cost of $400,000
- Although resulting from the casualty event, the pumping, cleaning, and replacing damaged drywall and flooring, does not directly benefit and is not incurred by reason of the roof replacement

Restoration after Casualty Loss: Limitation

- Cindy must capitalize as an improvement the $350,000 paid to the contractor to replace the roof structure because the roof structure constitutes a major component and a substantial structural part of the building unit of property
- She must treat as a restoration the remaining costs, limited to the excess of the adjusted basis of the building over the amounts paid for the improvement

Restoration after Casualty Loss: Limitation

- Cindy must treat as a restoration $150,000 ($500,000 - $350,000) of the $400,000 paid for the costs to repairing and cleaning the building structure
- In addition to the $350,000 to replace the roof structure, Cindy must also capitalize the $150,000 as an improvement to the building unit of property
- She is not required to capitalize the remaining $250,000 repair and cleaning costs

Table

Building	Basis	Work on Building	Expense
Adjusted Basis	$500,000		
Casualty Loss	($500,000)		
After Casualty	$ -0-		
Roof	$350,000	$350,000	
Flooring	$400,000 - $150,000	$150,000	$250,000
	Limitation	$500,000	

Restoration of Property In a State of Disrepair

- Danny owns and operates a farm with several barns and outbuildings
- He did not use or maintain one of the outbuildings on a regular basis, and the outbuilding fell into a state of disrepair
- The outbuilding previously was used for storage but can no longer be used for that purpose because the building is not structurally sound
- Danny decides to restore the outbuilding and pays an amount to shore up the walls and replace the siding

Restoration of Property In a State of Disrepair

- An amount is paid to improve a building if the amount is paid to restore the building structure or any building system
- The walls and siding are part of the building structure
- Danny must treat the amount paid to shore up the walls and replace the siding as a restoration of the building structure because the amounts return the building structure to its ordinarily efficient operating condition after it had deteriorated to a state of disrepair and was no longer functional for its intended use
- He must treat the amount paid to shore up the walls and replace the siding as an improvement to the building unit of property must capitalize the amount paid

Rebuild of Property to Like-new Condition Before End of Class Life

- Ellen is owns a fleet of trucks with a recovery period of 3 years for the tractors and 5 years for the trailers
- Every 8 to 10 years, she rebuilds the tractor units
- Ten years after Ellen places the units in service, she a rebuilds to the manufacturer's original specification, which includes:
- A complete disassembly
- Inspection
- Reconditioning or
- Replacement of components of the suspension and systems, trailer hitches, and other special equipment
- Ellen also modifies the unit to upgrade various components to the latest engineering standards
- The tractor unit is stripped to the frame, with all of its substantial components either reconditioned or replaced

Rebuild of Property to Like-new Condition Before End of Class Life

- The frame itself is the longest-lasting part of the unit and is reconditioned
- All the remaining components of the unit are restored before they are reassembled
- At the end of the rebuild, the unit has been restored to like-new condition under the manufacturer's specifications
- Assume the tractor unit is the unit of property

Rebuild of Property to Like-new Condition Before End of Class Life

- Ellen is not required to treat as an improvement and capitalize the amounts paid to rebuild the tractor unit, although the amounts paid restore the freight car to like-new condition, the amounts were not paid after the end of the class life of the tractor unit
- But, we also need to look at other code sections to determine whether any amounts must be capitalized because they are paid for the replacement of a major component or a substantial structural part of the unit of property

Rebuild of property to like-new condition after end of class life

- Assume the same facts as in the previous example, except that Ellen rebuilds the tractor unit 10 years after she places it in service
- Ellen then must treat the amount as an improvement and capitalize the amounts paid to rebuild the tractor unit car because the amounts paid restore the unit to like-new condition after the end of the class life

Replacement of Major Component or Substantial Structural Part: Personal Property

- George is a common carrier that owns a fleet of petroleum hauling trucks
- He pays to replace the existing engine, cab, and petroleum tank with a new engine, cab, and tank
- Assume the tractor of the truck (which includes the cab and the engine) is a single unit of property and that the trailer (which contains the petroleum tank) is a separate unit of property
- The new engine and the cab each constitute a part or combination of parts that comprise a major component of the tractor, because they perform a discrete and critical function in the operation of the tractor

Replacement of Major Component or Substantial Structural Part: Personal Property

- The cab constitutes a part or combination of parts that comprise a substantial structural part of the tractor
- The amounts paid for the replacement of the engine and the cab must be capitalized
- Moreover, the new petroleum tank constitutes a part or combination of parts that comprise a major component and a substantial structural part of the trailer
- Accordingly, the amounts paid for the replacement of the tank also must be capitalized

Repair Performed during Restoration

- At the same time George is replacing the engine and cab of the tractor he pays amounts to paint the cab of the tractor with its company logo and to fix a broken taillight on the tractor
- The repair of the broken taillight and the painting of the cab generally are deductible expenses
- However, a taxpayer must capitalize all the direct costs of an improvement and all the indirect costs that directly benefit or are incurred by reason of an improvement
- Repairs and maintenance that do not directly benefit or are not incurred by reason of an improvement are not required to be capitalized regardless of whether they are made at the same time as an improvement
- George's need to paint the logo arose from the replacement of the cab with a new cab
- George must capitalize the amounts paid to paint the cab as part of the improvement to the tractor because these amounts directly benefit and are incurred by reason of the restoration of the tractor

Repair Performed during Restoration

- The amounts paid to repair the broken tail light are:
- Not for the replacement of a major component
- Do not directly benefit, and
- Are not incurred by reason of the replacement of the cab or the, even though the repair was performed at the same time as these replacements
- George is not required to capitalize the amounts paid to repair the broken tail light

Related Amounts to Replace Major Component or Substantial Structural Part: Personal Property

- Hank owns a retail gasoline station, consisting of
  - A paved area used for automobile access to the pumps and parking areas
  - A building used to market gasoline, and
  - A canopy covering the gasoline pumps
  - Underground storage tanks (USTs) that are connected by piping to the pumps and are part of the gasoline pumping system
- The USTs are components of the gasoline pumping system

Related Amounts to Replace Major Component or Substantial Structural Part: Personal Property

- To comply with regulations issued by the Environmental Protection Agency
- Hank is required to remove and replace leaking USTs
- In 2015, he hires a contractor to perform the removal and replacement, which consists of:
  - Removing the old tanks
  - Installing new tanks with leak detection systems.
  - The removal of the old tanks includes removing the paving material covering the tanks
  - Excavating a hole large enough to gain access to the old tanks
  - Disconnecting any strapping and pipe connections to the old tanks, and
  - Lifting the old tanks out of the hole

Related Amounts to Replace Major Component or Substantial Structural Part: Personal Property

- Installation of the new tanks includes:
  - Placement of a liner in the excavated hole
  - Placement of the new tanks
  - Installation of a leak detection system
  - Installation of an overfill system
  - Connection of the tanks to the pipes leading to the pumps
  - Backfilling of the hole, and
  - Replacement of the paving.
- Hank also is required to pay a permit fee to the county to undertake the installation of the new tanks

Related Amounts to Replace Major Component or Substantial Structural Part: Personal Property

- Hank pays the permit fee to the county on October 15, 2015
- On December 15, 2015, the contractor completes the removal of the old USTs and bills Hank for the costs of removal
- On January 15, 2016, the contractor completes the installation of the new USTs and bills Hank for the remainder of the work
- Hank is a calendar year client
- His gasoline pumping system is the unit of property
- He must capitalize the amounts paid to replace the USTs as a restoration because the USTs are parts or combinations of parts that comprise a major component and substantial structural part of the gasoline pumping system

Related Amounts to Replace Major Component or Substantial Structural Part: Personal Property

- In addition, he must capitalize the costs of removing the old USTs because he did not take a loss on the disposition of the USTs
- The amounts to remove the USTs directly benefit and are incurred by reason of the restoration of, and improvement to, the gasoline pumping system
- Hank must also, capitalize the permit fees because they directly benefit and are incurred by reason of the improvement to the gasoline pumping system
- Finally, Hank must capitalize the related amounts paid to:
  - Improve the gasoline pumping system
  - The amount paid to remove the old USTs, and
  - The amount paid to install the new USTs
  - Even though the amounts were separately invoiced, paid to different parties, and incurred in different tax years

Not Replacement of Major Component: Incidental

- Jess owns a machine shop in which it makes dies used by manufacturers
- In 2015, she purchased a drill press for use in its production process
- In 2017, she discovers that the power switch assembly, which controls the supply of electric power to the drill press, has become damaged and cannot operate
- To correct this problem, Jess replaces the power switch assembly with comparable and commercially available replacement parts
- The drill press is a unit of property
- The power switch assembly is a small component of the drill press that may be removed and installed with relative ease

Not Replacement of Major Component: Incidental

- The power switch assembly is not a major component of the unit of property although the power assembly may affect the function of the drill press by controlling the supply of electric power, the power assembly is an incidental component of the drill press
- The power assembly is not a substantial structural part of the drill press
- Jess is not required to capitalize the costs to replace the power switch assembly

Replacement of Major Component or Substantial Structural Part: Roof

- Kate owns a manufacturing building
- She discovers several leaks in the roof of the building and hires a contractor to inspect and fix the roof
- The contractor discovers that a major portion of the decking has rotted and recommends the replacement of the entire roof
- Kate pays the contractor to replace the entire roof, including the:
- Decking
- Insulation
- Asphalt, and
- Various coatings

Replacement of Major Component or Substantial Structural Part: Roof

- An amount is paid to improve a building if the amount is paid to restore the building structure or any building system
- The roof is part of the building structure
- The entire roof performs a discrete and critical function in the building structure
- The roof comprises a major component of the building structure
- Because the roof comprises a large portion of the physical structure of the building structure, the roof comprises a substantial structural part of the building structure
- Kate must treat the amount paid to replace the roof as a restoration of the building and must capitalize the amount paid as an improvement

Not Replacement of Major Component or Substantial Structural Part: Roof Membrane

- Laurie owns a building in which it conducts its retail business
- The roof decking over the building is covered with a waterproof rubber membrane
- Over time, the rubber membrane begins to wear, and Laurie begins to experience leaks into its retail premises
- However, the building is still functioning in the business
- To eliminate the problems, a contractor recommends that Laurie replace the membrane on the roof with a new rubber membrane
- She pays the contractor to strip the original membrane and replace it with a new rubber membrane
- The new membrane is comparable to the original membrane but corrects the leakage problems

Not Replacement of Major Component or Substantial Structural Part: Roof Membrane

- An amount is paid to improve a building if the amount is paid to restore the building structure or any building system
- The roof, including the membrane, is part of the building structure
- The entire roof performs a discrete and critical function in the building structure
- The roof comprises a major component of the building structure
- Although the replacement membrane may aid in the function of the building structure, it does not, by itself, comprise a significant portion of the roof major component
- The replacement membrane does not comprise a substantial structural part of the building structure
- Laurie is not required to capitalize the amount paid to replace the membrane as a restoration of the building

Not a Replacement of Major Component or Substantial Structural Part: HVAC System

- Mary owns a building in which it operates an office that provides medical services
- The building contains one HVAC system, which is comprised of three furnaces, three air conditioning units, and duct work that runs throughout the building to distribute the hot or cold air throughout the building
- One furnace in the building breaks down, and Mary pays to replace it with a new furnace
- An amount is paid to improve a building if the amount is paid to restore the building structure or any building system
- The HVAC system, including the furnaces, is a building system
- The parts that provide the heating function in the system, the three furnaces, together, perform a discrete and critical function in the operation of the HVAC system
- They are therefore a major component of the HVAC system
- But, the single furnace is not a significant portion of this major component of the HVAC system, or a substantial structural part of the HVAC system
- Mary is not required to treat the amount paid to replace the furnace as a restoration of the building

Replacement of Major Component or Substantial Structural Part: HVAC System

- Nick owns a large office building in which it provides consulting services
- The building contains one HVAC system, which is comprised of:
- One chiller unit, one boiler, pumps, duct work, diffusers, air handlers, outside air intake, and a cooling tower
- The chiller unit includes the compressor, evaporator, condenser, and expansion valve, and it functions to cool the water used to generate air conditioning throughout the building
- Nick pays an amount to replace the chiller with a comparable unit
- An amount is paid to improve a building if the amount is paid to restore the building structure or any building system

Replacement of Major Component or Substantial Structural Part: HVAC System

- The HVAC system, including the chiller unit, is a building system
- The chiller unit performs a discrete and critical function in the operation of the HVAC system because it provides the cooling mechanism for the entire system
- The chiller unit is a major component of the HVAC system
- Because the chiller unit comprises a major component of a building system, Nick must treat the amount paid to replace the chiller unit as a restoration to the building
- And he must capitalize the amount paid as an improvement to the building

Not Replacement of Major Component or Substantial Structural Part: HVAC System

- Owen owns an office building that it uses to provide services to customers
- The building contains a HVAC system that incorporates ten roof-mounted units that provide heating and air conditioning for the building
- The HVAC system also consists of controls for the entire system and duct work that distributes the heated or cooled air to the various spaces in the building's interior
- Own begins to experience climate control problems in various offices throughout the office building and consults with a contractor to determine the cause
- The contractor recommends that Owen replace three of the roof-mounted heating and cooling units
- He pays to replace the three specified units
- No work is performed on the other roof-mounted heating and cooling units, the duct work, or the controls

Not Replacement of Major Component or Substantial Structural Part: HVAC System

- An amount is paid to improve a building if the amount restores the building structure or any building system
- The HVAC system, including the 10 roof-mounted heating and cooling units, is a building system
- As the components that generate the heat and the air conditioning in the HVAC system, the 10 roof-mounted units, together, perform a discrete and critical function in the operation of the HVAC system and, are a major component of the HVAC system
- The three roof-mounted heating and cooling units are not a significant portion of a major component of the HVAC system or a substantial structural part of the HVAC system
- Own is not required to treat the amount paid to replace the three roof-mounted heating and cooling units as a restoration of the building

Replacement of Major Component or Substantial Structural Part: Fire Protection System

- Paul owns a building that it uses to operate its business
- He pays an amount to replace the sprinkler system in the building with a new sprinkler system
- An amount is paid to improve a building if the amount restores the building structure or any building system
- The fire protection and alarm system, including the sprinkler system, is a building system
- As the component that provides the fire suppression mechanism in the system, the sprinkler system performs a discrete and critical function in the operation of the fire protection and alarm system and is therefore a major component of the system
- Because the sprinkler system comprises a major component of a building system, Paul must treat the amount paid to replace the sprinkler system as restoration to the building unit of property and must capitalize the amount paid as an improvement to the building

Replacement of Major Component or Substantial Structural Part: Electrical System

- Thomas owns a building that it uses to operate its business
- He pays an amount to replace the wiring throughout the building with new wiring that meets building code requirements
- An amount is paid to improve a building if the amount restores the building structure or any building system
- The electrical system, including the wiring, is a building system
- As the component that distributes the electricity throughout the system, the wiring performs a discrete and critical function
- The wiring also comprises a large portion of the physical structure of the electrical system
- Because the wiring comprises a major component and a substantial structural part of a building system, Thomas must treat the amount paid to replace the wiring as a restoration to the building and must capitalize the amount paid as an improvement to the building

Not a Replacement of Major Component or Substantial Structural Part: Electrical System

- Ronda owns a building that it uses to operate its business
- She pays to replace 30 percent of the wiring throughout the building with new wiring that meets building code requirements
- An amount is paid to improve a building if the amount restores the building structure or any building system
- The electrical system, including the wiring, is a building system
- All the wiring in the building comprises a major component because it performs a discrete and critical function in the operation of the electrical system
- However, the portion of the wiring that was replaced is not a significant portion of the wiring major component nor does it comprise a substantial structural part of the electrical system
- The replacement of 30 percent of the wiring is not the replacement of a major component or substantial structural part of the building
- Ronda is not required to treat the amount paid to replace 30 percent of the wiring as a restoration to the building

Replacement of Major Component or Substantial Structural Part: Plumbing System

- Susan owns a building in which it conducts a retail business
- The retail building has three floors
- The retail building has men's and women's restrooms on two of the three floors
- Susan decides to update the restrooms by paying to replace the plumbing fixtures in all of the restrooms, including all the toilets and sinks, with modern style plumbing fixtures of similar quality and function
- Susan does not replace the pipes connecting the fixtures to the building's plumbing system
- An amount is paid to improve a building if the amount restores the building structure or any building system

Replacement of Major Component or Substantial Structural Part: Plumbing System

- The plumbing system, including the plumbing fixtures, is a building system
- All the toilets together perform a discrete and critical function in the operation of the plumbing system
- All the sinks, together, also perform a discrete and critical function in the operation of the plumbing system
- All the toilets comprise a major component of the plumbing system, and all the sinks comprise a major component of the plumbing system
- Susan must treat the amount paid to replace all of the toilets and all of the sinks as a restoration of the building and must capitalize the amount paid as an improvement to the building

Building Safe Harbor Qualifying Businesses

- The client can benefit from the buildings safe harbor, if they are a "qualifying taxpayers"
  - Average annual gross receipts for the three preceding tax years is less than or equal to $10,000,000
- There are specific rules provided taxpayers who have been in existence less than 3 years
- If one of the 3 preceding tax years is a short year, then the gross receipts from that year must be annualized
- The term "gross receipts" is specifically defined in the regulations to include total sales (net of returns or allowances), all amounts received for services, all investment or other income, and is not reduced by the cost of goods sold

Safe harbor for small taxpayers

- A qualifying taxpayer may elect to not apply the requirement to capitalize amounts paid for improvements or, improvements to leased property, to an eligible building property (has an unadjusted basis of 1M or less) if the total amount paid during the taxable year for repairs, maintenance, improvements, and similar activities performed on the eligible building property does not exceed:
  - 2 % percent of the unadjusted basis of the eligible building property; or
  - $10,000

Questions?

Repair Regulations Webinars

- October 27, 2015 Buildings: Restoration : Noon to 1 pm CST
- October 28, 2015 Buildings: Adaptation : Noon to 1 pm CST
- October 29, 2015: Dispositions : Noon to 1 pm CST
- October 30, 2015 Other Remaining Issues of Importance : Noon to 1 pm CST

January
Getting Ready for Filing Season Webinars

- Free- Getting Ready for Filing Season – January 12, no CPE offered
- EITC Due Diligence – January 14 - $35.00
- Identity Theft – January 19 - $35.00
- 1 hour each CPE for EITC Due Diligence and Identity Theft

CALT Website

http://www.calt.iastate.edu/

Tour of the CALT Website

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