

# IRS News Release

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## **Proposed Regulations Issued for Capitalization of Tangible Assets**

IR-2006-130, August 18, 2006

WASHINGTON — The Treasury Department and the Internal Revenue Service issued proposed regulations that clarify the treatment of expenditures incurred in selling, acquiring, producing or improving tangible assets. If adopted as proposed, the regulations should reduce the amount of controversy between taxpayers and the IRS in this area.

For many years, there has been controversy about whether taxpayers are required to capitalize certain expenditures as an improvement or take an immediate deduction for the expenditures as necessary repair and maintenance expenses. There has been debate on how to apply the tests used to determine the tax treatment of these types of expenses.

The proposed regulations provide an overall framework that expands the standards in the current regulations by drawing on principles developed through case law. Specifically, the proposal provides exclusive factors for determining whether amounts paid to restore property to its former working condition must be capitalized as an improvement.

The proposed regulations also provide guidance concerning the economic useful life of a unit of property and activities that substantially prolong the economic useful life. Additionally, the proposed regulations provide rules for determining the appropriate unit of property to which the rules should be applied.

To reduce the administrative and compliance costs associated with this section of the tax code, the proposed regulations provide several safe harbors and simplifying assumptions. Although the proposed regulations do not provide a de minimis rule in which small cost items are exempt from capitalization, the preamble solicits comments on whether such a rule should be adopted in final regulations. The Treasury Department and the IRS expect to receive a number of comments on the proposed regulations and will take those comments into consideration before finalizing the regulations.

The Treasury Department and the IRS plan to address in future guidance the treatment of costs related to the development and implementation of computer software and costs required to be capitalized in certain transactions including tax-free acquisitive transactions and stock issuance transactions.