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# Proposed Regulations Issued for Capitalization of Tangible Assets

IR-2008-35, March 7, 2008

WASHINGTON — The Treasury Department and the Internal Revenue Service issued proposed regulations to clarify the treatment of expenditures incurred in selling, acquiring, producing or improving tangible assets.

These proposed regulations replace the regulations that were proposed by the Treasury Department and the IRS in August 2006, and take into account many of the comments received in response to the 2006 proposed regulations.

For many years, there has been controversy about how taxpayers characterize certain expenditures for tax purposes. Expenditures that result in improvements must be capitalized and cannot be immediately deducted, but those that are necessary repair and maintenance expenses may be deducted immediately. There has been uncertainty on how to apply the tests used to determine when expenses may be deducted immediately and when expenses must be capitalized and depreciated over a certain number of years.

Like the 2006 proposed regulations, these proposed regulations provide guidance on how to determine whether an expenditure must be capitalized as an improvement cost. Specifically, these proposed regulations require capitalization of expenditures that result in a betterment or restoration of the property, and they describe the factors to be used in determining whether an expenditure results in a betterment or restoration.

The proposed regulations also provide guidance concerning the appropriate unit of property to which the betterment and restoration rules should be applied. All of these rules have been revised from the 2006 proposed regulations in response to the concerns raised by commentators.

In addition, the proposed regulations address expenditures to sell, acquire, or produce tangible property. The 2006 proposed regulations also addressed these expenditures, but this new proposal expands on those rules by providing specific rules regarding material and supplies, and by addressing the treatment of expenditures to facilitate the acquisition or production of property.

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To reduce administrative and compliance costs the proposed regulations provide some safe harbors and simplifying assumptions. For example, the proposed regulations provide a de minimis rule under which small cost items are exempt from capitalization. The proposed regulations also provide a safe harbor that allows taxpayers to deduct certain routine maintenance expenses. Finally, taxpayers governed by regulatory accounting principles may use an optional regulatory accounting method.