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Capitalization vs. Expense - General Rules

- Section 162 allows a deduction for ordinary and necessary business expenses, including amounts paid for incidental repairs and maintenance.
- Section 263(a) requires taxpayers to capitalize, rather than deduct, amounts paid to acquire, produce, or improve tangible and intangible property.
- Capitalized costs generally are recovered through depreciation (for tangible property) or amortization (for intangible property).

Overview of Final Tangible Property Regulations under Sections 162 & 263(a)

- § 1.162-3 – Material and Supplies
- § 1.162-4 – Repairs and Maintenance
- § 1.263(a)-1 – Capital Expenditures; in general
 - § 1.263(a)-1(f) – De Minimis Safe Harbor Election
- § 1.263(a)-2 – Acquisition and Production of Tangible Property
- § 1.263(a)-3 – Improvements to Tangible Property

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Acquisition and Production Costs – § 1.263(a)-2

- **Requirement to Capitalize** – A taxpayer must capitalize amounts paid to acquire or produce a unit of real or personal property (UOP), including--
 - Invoice price;
 - Transaction costs;
 - Costs for work performed prior to the date the UOP is placed in service by the taxpayer; and
 - Amounts paid to defend or perfect title to a UOP
- **Important Exceptions:**
 - De Minimis Safe Harbor Election -- § 1.263(a)-1(f)
 - Materials and Supplies -- § 1.162-3

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De minimis Safe Harbor Election

§ 1.263(a)-1(f)

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De Minimis Safe Harbor Taxpayers with Applicable Financial Statements

- A taxpayer electing the de minimis safe harbor may not capitalize or treat as materials or supplies amounts paid to acquire or produce a unit of tangible property, if—
 - The taxpayer **has an AFS**;
 - The taxpayer has, at the beginning of the taxable year, **written accounting procedures** treating as an expense for non-tax purposes—
 - Amounts paid for property costing less than a certain **dollar amount**; or
 - Amounts paid for property with an economic useful life of **12 months or less**;
 - The taxpayer **treats the amounts paid during the taxable year as an expense on its AFS** in accordance with its written accounting procedures; and
 - The amount paid for the property does not exceed **\$5,000** per invoice (or per item substantiated by invoice).

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