
(Company Name)

Capitalization Policy

Effective Date: January 1, 2014

1. Purpose

This accounting policy establishes the minimum cost (capitalization amount) that shall be used to determine the capital assets that are to be recorded in (Company Name)'s annual financial statements (or books).

2. Capital Asset definition

A "Capital Asset" is defined as a unit of property that: (1) has an economic useful life that extends beyond 12 months; **and** (2) was acquired or produced for a cost of more than \$_____. Capital Assets must be capitalized and depreciated for financial statement (or bookkeeping) purposes.

3. Capitalization thresholds

(Company Name) establishes \$_____ as the threshold amount for minimum capitalization. Any items costing below this amount should be expensed in (Company Name)'s financial statements (or books).

4. Capitalization method and procedure

All Capital Assets are recorded at historical cost as of the date acquired.

Tangible assets costing below the aforementioned threshold amount are recorded as an expense for (Company Name)'s annual financial statements. Alternatively, assets with an economic useful life of 12 months or less are required to be expensed for financial statement purposes, regardless of the acquisition or production cost.

5. Recordkeeping

Invoices substantiating an acquisition cost of each unit of property shall be retained for a minimum of seven years.

Quick Summary of Final Tangible Property Regulations

This summary is intended to provide a high-level overview only and should not be relied on for application to specific fact patterns and situations. Taxpayers should consult their tax advisors to determine how the final or proposed regulations will apply to their specific facts and situations.

Materials and Supplies		
Effective Date	<ul style="list-style-type: none"> • Applicable to amounts paid or incurred in taxable years beginning on or after January 1, 2014 in general • Early adoption available for amounts paid or incurred in taxable years beginning on or after January 1, 2012 	
Definition of Materials and Supplies (M&S)	<ul style="list-style-type: none"> • A unit of property (UoP) costing \$200 or less • UoP with an economic useful life of 12 months or less • Component to maintain, repair or improve a UoP, including rotatable, temporary and standby emergency spare parts • Fuel, lubricants, water, etc. reasonably expected to be consumed in 12 months or less • Identified as M&S in other IRS guidance 	
Types of M&S and Timing of Deduction	<ul style="list-style-type: none"> • Incidental – deductible when paid or incurred • Non-incidental – deductible when first consumed/used • Rotatable, and temporary spare parts – deductible when disposed (optional method available) 	
Election to Capitalize Certain M&S	<ul style="list-style-type: none"> • May elect to capitalize and depreciate rotatable, temporary or standby emergency spare parts • Election made by capitalizing one or more rotatable, temporary or standby emergency spare parts on timely filed return (no statement required) • Late election available by filing amended 2012 and 2013 returns 	
De Minimis Safe Harbor Election		
Effective Date	<ul style="list-style-type: none"> • Applicable to amounts paid or incurred in taxable years beginning on or after January 1, 2014 • Early adoption available for amounts paid or incurred in taxable years beginning on or after January 1, 2012 • Late election available by filing amended 2012 and 2013 returns 	
Requirements ([^] AFS = Certified audited financial statements, SEC or regulatory filing)	<u>Taxpayers with Applicable Financial Statements (AFS[^])</u> <ol style="list-style-type: none"> 1. Written book capitalization policy (based on a specified amount or useful life of 12 months or less) in place at beginning of the tax year 2. Must expense amounts in AFS according to the policy 3. Amount paid for UoP must be \$5,000 or less per invoice (or per item as substantiated on the invoice) 	<u>Taxpayers without Applicable Financial Statements (AFS[^])</u> <ol style="list-style-type: none"> 1. Accounting procedures (based on a specified amount or useful life of 12 months or less) in place at beginning of the tax year 2. Must expense in books and records according to the accounting procedure 3. Amount paid for UoP must be \$500 or less per invoice (or per item as substantiated on the invoice)

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De Minimis Safe Harbor Election, continued

Requirements	<ol style="list-style-type: none"> 4. Additional costs (e.g., delivery fees, installation) included in determining cost only if included on the same invoice as item itself 5. Lump-sum fee allocable to multiple invoices 6. File annual election statement with timely filed original return including extensions 7. Anti-abuse rule (e.g., improper splitting of costs to multiple invoices prohibited) 8. Applies to only tangible property; intangibles are not eligible (i.e., computer software) 9. Does not apply to: (1) land; (2) inventory; (3) rotatable, temporary or emergency spare parts that taxpayer has elected to capitalize; or (4) rotatables and temporary spare parts for which taxpayer uses the optional method 10. If elected, must apply to all items that qualify <ul style="list-style-type: none"> • Amounts over the safe harbor amount may be allowed (clear reflection of income) 	<ol style="list-style-type: none"> 4. Additional costs (e.g., delivery fees, installation) included in determining cost only if included on the same invoice as item itself 5. Lump-sum fee allocable to multiple invoices 6. File annual election statement with timely filed original return including extensions 7. Anti-abuse rule (e.g., improper splitting of costs to multiple invoices prohibited) 8. Applies to tangible property only; intangibles are not eligible (i.e., computer software) 9. Does not apply to: (1) land; (2) inventory; (3) rotatable, temporary or emergency spare parts that taxpayer has elected to capitalize; or (4) rotatables and temporary spare parts for which taxpayer uses the optional method 10. If elected, must apply to all items that qualify <ul style="list-style-type: none"> • Amounts over the safe harbor amount may be allowed (clear reflection of income)
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Acquisition costs

Effective Date	<ul style="list-style-type: none"> • Generally applies to taxable years beginning on or after January 1, 2014 • Early adoption generally available for taxable years beginning on or after January 1, 2012
General rule	<ul style="list-style-type: none"> • Amounts paid or incurred to acquire or produce tangible property must be capitalized • Transaction costs (i.e., facilitative costs) must be capitalized
Transaction Costs	<ul style="list-style-type: none"> • Facilitative costs include amounts paid or incurred in the process of investigating or otherwise pursuing the acquisition • Costs that are inherently facilitative include <ul style="list-style-type: none"> – Transporting the property (e.g., shipping fees and moving costs) – Securing an appraisal or determining the value or price of property – Negotiating the terms or structure of the acquisition and obtaining tax advice on the acquisition – Application fees, bidding costs, or similar expenses – Preparing and reviewing the documents that effectuate the acquisition of the property (for example, preparing the bid, offer, sales contract, or purchase agreement)

Quick Summary of Final Tangible Property Regulations

Acquisition costs, continued	
Transaction Costs	<ul style="list-style-type: none"> – Examining and evaluating the title of property – Obtaining regulatory approval of the acquisition or securing permits related to the acquisition, including application fees – Conveying property between the parties, including sales and transfer taxes, and title registration costs – Finders’ fees or brokers’ commissions, including amounts paid or incurred that are contingent on the successful closing of the acquisition – Architectural, geological, engineering, environmental, or inspection services pertaining to particular properties – Services provided by a qualified intermediary or other facilitator of a section 1031 like-kind exchange • Inherently facilitative costs may be allocated between property acquired and property not acquired <ul style="list-style-type: none"> – Contingency fees must be wholly allocated to property acquired – Applicable to amounts paid or incurred in taxable years beginning on or after January 1, 2014 • Investigatory costs for real property are generally not facilitative costs (unless inherently facilitative) <ul style="list-style-type: none"> – Applicable to amounts paid or incurred in taxable years beginning on or after January 1, 2012 • Employee compensation and overhead not facilitative (unless taxpayer elects to treat as facilitative) <ul style="list-style-type: none"> – Applicable to amounts paid or incurred in taxable years beginning on or after January 1, 2014
Election to capitalize employee compensation and/or overhead	<ul style="list-style-type: none"> • Annual acquisition-by-acquisition election to capitalize employee compensation and/or overhead costs made by capitalizing (i.e., no election statement required) on timely filed, original tax return for tax year the amounts are paid or incurred • Applicable to amounts paid or incurred in taxable years beginning on or after January 1, 2014 • Early adoption available for amounts paid or incurred in taxable years beginning on or after January 1, 2012 • Late election available by filing amended 2012 and 2013 returns
Improvement Costs	
<p>Amounts paid for betterment, restoration, or adaptation to a UoP generally must be capitalized</p> <p>Cost of removing a UoP (or component thereof) may not be required to be capitalized, depending on whether a disposition is recognized for Federal income tax purposes</p>	
Effective Date	<ul style="list-style-type: none"> • Applicable in taxable years beginning on or after January 1, 2014 in general • Early adoption available for taxable years beginning on or after January 1, 2012
Unit of Property (UoP)	<ul style="list-style-type: none"> • General rule - functionally interdependent components • Special rules <ul style="list-style-type: none"> – Buildings, network assets, plant property, and leased property

Quick Summary of Final Tangible Property Regulations

<i>Improvement Costs, continued</i>	
UoP (Buildings)	<ul style="list-style-type: none"> • Building and its structural components constitute one UoP • However, improvement standards must be applied separately to building structure and/or defined building systems, as applicable <ul style="list-style-type: none"> – Building systems – include Heating, Ventilation, and Air Conditioning System (HVAC), plumbing systems, electric systems, all escalators, all elevators, fire protection and alarm systems, security systems, gas distribution systems, and other structural components identified in published guidance – Building structure – include building defined under § 1.48-1(e)(1) and its components under § 1.48-1(e)(2), other than building systems above
UoP (Plant Property)	<ul style="list-style-type: none"> • Plant property – functionally interdependent machinery or equipment performing <u>industrial process</u> <ul style="list-style-type: none"> – Further broken up to smaller units that perform a discrete and major function
UoP (Leased Property)	<ul style="list-style-type: none"> • Lessee applies general rules applicable to type of property, however UoP cannot be larger than the leased portion of the item • Lessor applies general rules to each building and its components
Small Taxpayer Safe Harbor	<ul style="list-style-type: none"> • Annual election not to capitalize improvements to eligible building(s) (election applied on an eligible-by-eligible building basis) <ul style="list-style-type: none"> – Owned or leased building must have an unadjusted basis of \$1M or less (eligible building) – Taxpayers must have avg. annual gross receipts of \$10M or less (3 prev. years) (qualifying taxpayer) – Total amounts for repair, maintenance and improvement expenses for the tax year must not exceed lesser of \$10,000 or 2% of unadjusted basis of eligible building <ul style="list-style-type: none"> ▪ Amounts deducted under the de minimis safe harbor and routine maintenance safe harbor for building must be included when computing the annual amount paid or incurred for repair, maintenance and improvement to building – Include election statement with timely filed, original return, including extensions • Applicable to amounts paid or incurred in taxable years beginning on or after January 1, 2014 • Early adoption available for amounts paid or incurred in taxable years beginning on or after January 1, 2012 • Late election available by filing amended 2012 and 2013 returns
Betterment	<ul style="list-style-type: none"> • Corrects material defects • A material addition (physical enlargement, expansion, extension or addition of a major component or space) • Reasonably expected to materially increase strength, productivity, efficiency, quality, or output of the UoP

Quick Summary of Final Tangible Property Regulations

<i>Improvement Costs, continued</i>	
Restoration	<ul style="list-style-type: none"> • Replacement of a component of a UoP <ul style="list-style-type: none"> – Taxpayer has properly deducted a loss other than a casualty loss <ul style="list-style-type: none"> ▪ Does not apply if loss is attributable only to remaining salvage value – Taxpayer has properly taken into account the adjusted basis of the component in realizing gain or loss from sale or exchange <ul style="list-style-type: none"> ▪ Does not apply if loss is attributable only to remaining salvage value • Restoration of damage to a UoP for which the taxpayer is required to adjust basis as a result of a casualty (casualty loss rule) • Returning UoP 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 • Rebuilding of a UoP to a like-new condition after the end of its ADS class life • Replacement of a part or a combination of parts that comprises a major component (or significant portion of a major component for building property) or substantial structural part
Casualty Loss Rule	<ul style="list-style-type: none"> • Amount to capitalize limited to the excess of <ul style="list-style-type: none"> – Adjusted basis of single identifiable property for determining the loss on the casualty, over – Amount paid for restoration of damage to the UoP from the casualty that would otherwise be a capitalized restoration • Apply improvement standards to amounts in excess of limitation above
Adaptation	<ul style="list-style-type: none"> • Capitalize amounts paid for adapting a UoP to a new or different use <ul style="list-style-type: none"> – New or different use – inconsistent with intended use of UoP when originally placed in service
Routine Maintenance Safe Harbor	<ul style="list-style-type: none"> • Routine and recurring amounts paid to keep a UoP in ordinary efficient working condition may be treated as repair costs <ul style="list-style-type: none"> – Non-building property – must reasonably expect to perform activity <u>more than once</u> during UoP’s ADS class life – Building property (structural components or building systems) – must reasonably expect to perform activity <u>more than once</u> during 10-year period beginning with placed in service date (of structure or system, as applicable) – Only applies to amounts otherwise capitalized under certain restoration provisions – Does not apply to rotatable spare parts accounted for under optional method – Consider recurring nature of activity, taxpayer’s experience, manufacturer recommendations, and industry practice – Use of safe harbor constitutes a method of accounting
Election to Capitalize for tax	<ul style="list-style-type: none"> • Annual election to capitalize otherwise deductible repairs if capitalized for book • Include election statement with timely filed, original tax return, including extensions • Applicable to amounts paid or incurred in taxable years beginning on or after January 1, 2014 • Early adoption available for amounts paid or incurred in taxable years beginning on or after January 1, 2012 • Late election available by filing amended 2012 and 2013 returns

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Dispositions (As Re-Proposed)	
Effective Date	<ul style="list-style-type: none"> • May rely on proposed rules for taxable years beginning on or after January 1, 2012 (and before January 1, 2014)
Dispositions	<ul style="list-style-type: none"> • Transfer of ownership or permanent withdrawal from trade or business of an asset including: <ul style="list-style-type: none"> – Sale or exchange – Retirement – Physical abandonment – Destruction (including casualty) – Transfer to supplies, scrap, or similar account – Involuntary conversion • Disposition of portion of an asset as result of: <ul style="list-style-type: none"> – Casualty event – Disposition for tax-deferred exchanges under §§ 1031 and 1033 – Transfer described under § 168(i)(7) – Sale of portion of asset – Partial disposition election <ul style="list-style-type: none"> ▪ Optional annual election to treat a partial disposition of an asset as a disposition ▪ Note that partial disposition is required for casualty event, §§ 1031 or 1033 transaction, § 168(i)(7) transfer, and sale of portion of an asset
General Asset Account (GAA)	<ul style="list-style-type: none"> • Option to group assets into a single GAA (Elective) <ul style="list-style-type: none"> – Same depreciation method – Same recovery period – Same convention – Same taxable year (placed in service date) • No loss on disposition recognized
GAA disposition elections	<ul style="list-style-type: none"> • Terminate GAA and recover adjusted depreciable basis of GAA upon disposing of all assets remaining in GAA • Recognize qualifying disposition of an asset or portion of an asset (narrow definition of qualifying disposition)