# FAQ Tangible Property Regulations (TPRs) ( 10 questions)

1. **What are the Tangible Property Regulations (TPRs), and why were they created?**

The Tangible Property Regulations (TPRs) are mandatory IRS guidelines for property owners that define whether costs incurred on tangible property should be immediately deducted as an expense or capitalized and depreciated over time. They were established to provide a more transparent and more predictable framework for taxpayers, thereby reducing conflicts with the IRS. Before the TPRs, determining whether an expense was a deductible repair or a capital expenditure was often subjective, leading to significant disputes. The TPRs consolidate decades of inconsistent case law and administrative rulings into a system. They took effect on January 1, 2014, and are considered a significant tax change for real estate owners.

2. **Are the Tangible Property Regulations optional?**

No, the Tangible Property Regulations are not optional. Compliance with the Tangible Property Regulations (TPRs) is mandatory for all taxpayers who incur costs to acquire, improve, or produce tangible property. Failure to adhere to these regulations can result in significant financial penalties, including the disallowance of depreciation deductions for both current and prior tax years, which can lead to substantial back taxes, penalties, and interest charges. Correcting non-compliance typically requires filing IRS Form 3115, Application for Change in Accounting Method.

3. **What is the Unit of Property (UOP), and why is its correct identification important?**

The Unit of Property (UOP) is a fundamental concept within the TPR used by the IRS to determine the tax treatment of expenses related to tangible property. For buildings, each standalone structure is generally considered an individual unit of property (UOP). The proper identification of the UOP is essential because it sets the boundary for applying the TPR rules, such as determining whether an expenditure is a deductible repair or a capitalizable improvement. Misidentifying the UOP can lead to incorrect capital versus expense decisions, potentially resulting in missed tax savings or non-compliance with IRS regulations.

4. **What are Building Systems, and why is understanding them beneficial?**

Once the Unit of Property (UOP) for a building is determined, the building is further broken down into specific building systems for separate accounting. These systems can encompass up to nine categories, including HVAC, plumbing, electrical, fire protection systems, escalators, elevators, gas distribution, and security systems.

Understanding the value and nature of each building system enables property owners to make more informed decisions about whether to capitalize or expense costs related to those systems, thereby optimizing tax benefits and ensuring compliance.

5. **What are Safe Harbors, and what is their main benefit?**

Safe Harbors are elective, simplifying provisions under the TPRs that allow certain expenditures to be expensed immediately without detailed scrutiny. They provide administrative convenience, particularly for small items or routine maintenance. The primary benefit of using a Safe Harbor is the ability to immediately deduct qualifying costs in the current tax year, thereby simplifying record-keeping and providing immediate tax relief. There are several Safe Harbors available, including the De Minimis Safe Harbor, the Small Taxpayer Safe Harbor, and the Routine Maintenance Safe Harbor.

6. **Explain the eligibility requirements for the Small Taxpayer Safe Harbor (STSH).**

The Small Taxpayer Safe Harbor (STSH) is an annual election available to taxpayers with average annual gross receipts of $10 million or less. This safe harbor allows eligible taxpayers to expense the lesser of 2% of the building's adjusted basis or $10,000 annually for certain building improvement costs. Expenditures expensed under the De Minimis Safe Harbor for building improvements also count towards this STSH limit. Land improvements are excluded from this safe harbor.

7. **Describe the Routine Maintenance Safe Harbor (RMSH) and how it differs from other Safe Harbors.**

The Routine Maintenance Safe Harbor (RMSH) permits the expensing of costs incurred for routine maintenance that is expected to be performed regularly, typically within 10 years, to maintain an asset in its normal operating condition. This safe harbor is distinct from the De Minimis Safe Harbor and the Small Taxpayer Safe Harbor in that it does not require an annual election and does not have a specific dollar limit. However, the maintenance must not improve, enlarge, or materially increase the efficiency of the property to qualify under this safe harbor.

8. **When do the RABI rules need to be considered by a taxpayer?**

The RABI rules (Restoration, Adaptation, Betterment, Improvement) are considered when Safe Harbors do not apply to an expenditure on a tangible property component. These rules outline specific criteria for determining whether an expenditure must be capitalized, as it represents an improvement or significant change to the property, as opposed to a routine repair that can typically be expensed. Expenditures generally must be capitalized if they fall under the definition of a Restoration (e.g., repairs within two years of occupancy or to an asset in total disrepair), Adaptation (changing the original intended use), Betterment (making a component significantly more efficient, larger, or valuable), or Improvement (affecting a significant portion of like components).

**9. What is the Timeline of Events for Tangible Property Regulations?**

1. Before September 17, 2013: Taxpayers and the IRS relied on inconsistent case law and administrative rulings to determine whether costs related to tangible property should be expensed or capitalized. This led to significant controversy and disputes.
2. September 17, 2013: The final Tangible Property Regulations (TPRs) are issued under Treasury Decision 9636 by the Treasury Department and the IRS. These regulations consolidate decades of case law and administrative rulings into a clearer, more predictable framework.
3. January 1, 2014: The Tangible Property Regulations (TPRs) became effective. These regulations are mandatory guidelines for all taxpayers who incur costs to acquire, improve, or produce tangible property. This is considered the most significant tax change for real estate owners since the Tax Reform Act of 1986.
4. After January 1, 2014: Taxpayers are required to comply with the TPRs, using concepts like Unit of Property (UOP), Building Systems, Safe Harbors (De Minimis Safe Harbor, Small Taxpayer Safe Harbor, Routine Maintenance Safe Harbor), and the RABI rules (Restoration, Adaptation, Betterment, Improvement) to determine if expenditures should be expensed or capitalized.
5. January 1, 2016: The De Minimis Safe Harbor (DMSH) threshold for taxpayers without applicable financial statements increases from $500 to $2,500 per item or invoice.
6. Ongoing (from January 1, 2014): The IRS actively enforces the TPRs. Non-compliance can result in the disallowance of depreciation deductions, as well as back taxes, penalties, and interest. Correcting non-compliance often requires filing IRS Form 3115, Application for Change in Accounting Method.

**10. What is the Role of Taxpayers, the IRS, and the Treasury Department?**

**Taxpayers:** Property owners and businesses who incur costs related to tangible property. They are subject to the mandatory Tangible Property Regulations and are responsible for determining whether to expense or capitalize these costs in compliance with the rules.

**Internal Revenue Service (IRS):** The U.S. government agency responsible for collecting taxes and enforcing tax laws. The IRS created and enforces the Tangible Property Regulations to provide a more transparent framework for distinguishing between repair and capitalization decisions, thereby reducing disputes. They actively enforce compliance and can impose penalties for non-adherence.

**Treasury Department:** The executive department of the U.S. government responsible for the national treasury and revenue. The Treasury Department, along with the IRS, issued the final Tangible Property Regulations (Treasury Decision 9636).

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