# Repair or improvement: Does the distinction matter under current tax law?

Ordinary repair and maintenance costs are generally deductible in the year they're paid or incurred, depending on your accounting method. Costs that *improve* property must be capitalized. However, under current tax law, capitalization doesn't necessarily mean waiting years to recover the cost. The One Big Beautiful Bill Act (OBBBA) permanently restored 100% bonus depreciation for eligible property and increased the Section 179 expensing limit and phaseout threshold.

Still, these provisions don't cover every improvement. And even when an improvement qualifies for one of these breaks, repair treatment may offer certain advantages. Here's a closer look at why distinguishing repairs from improvements remains important — and why you should consider all available deduction options.

**Improvement tests**

Generally, *repairs* keep property in ordinarily efficient operating condition without adding significant value or substantially extending its useful life. Examples might include fixing a leak, replacing a small number of damaged roof shingles or servicing machinery. An expenditure generally must be treated as an *improvement* and, therefore, be capitalized if it results in a betterment, restoration or adaptation of the unit of property:

- Under the “betterment test,” you generally must capitalize amounts paid for work that’s reasonably expected to materially increase the productivity, efficiency, strength, quality or output of a unit of property or that’s a material addition to a unit of property.
- Under the “restoration test,” you generally must capitalize amounts paid to replace a part (or combination of parts) that’s a major component or a significant portion of the physical structure of a unit of property.
- Under the “adaptation test,” you generally must capitalize amounts paid to adapt a unit of property to a new or different use — one that isn’t consistent with your ordinary use of the unit of property at the time you originally placed it in service.

For a building, these tests generally apply separately to the building structure and designated systems, such as plumbing, electrical, HVAC, elevators, fire protection and security. Consequently, replacing an entire building system may be an improvement even if the work affects only a portion of the building.

**Tangible property safe harbors**

Several safe harbors may allow expenditures that might otherwise be capitalized to be deducted currently:

**Routine maintenance safe harbor.** Recurring work performed to keep property in ordinarily efficient operating condition may be deductible. At the time the property was placed in service, you must have reasonably expected to perform the activity more than once during a 10-year period for buildings or during the applicable class life (such as three years or seven years) for other property.

**Safe harbor for small businesses.** Businesses with average annual gross receipts of $10 million or less during the three preceding tax years may qualify for an annual election to currently deduct the cost of work on an eligible building with an unadjusted basis of $1 million or less. The total amount paid for repairs, maintenance and improvements during the year must be no more than the lesser of $10,000 or 2% of the building’s unadjusted basis.

**De minimis safe harbor.** Subject to accounting-policy and recordkeeping requirements, a business may elect to deduct qualifying expenditures up to $2,500 per invoice or item. The threshold is $5,000 for a business with an applicable financial statement, such as a qualifying audited financial statement.

These safe harbors have specific requirements, and some elections must be made annually on a timely filed tax return.

## 100% first-year deductions for capitalized costs

If an expenditure must be capitalized, you may still be able to deduct its full cost in the year the improvement is placed in service. The OBBBA permanently restored 100% bonus depreciation for eligible property acquired and placed in service after January 19, 2025. Qualifying property generally includes machinery, equipment and real estate qualified improvement property (QIP).

QIP generally consists of improvements made to the interior of an existing nonresidential building. However, expenditures attributable to enlarging a building, elevators or escalators, or the internal structural framework of a building don't count as QIP and are usually depreciated over 39 years.

Sec. 179 may also cover machinery, equipment and QIP, as well as certain improvements to nonresidential real property, including roofs, HVAC systems, fire protection and alarm systems, and security systems. The OBBBA doubled the expensing limit for 2025 and also increased the phaseout threshold, but less significantly. These amounts are annually indexed for inflation. For 2026, businesses may deduct up to $2.56 million of eligible costs. The deduction begins to phase out when qualifying purchases in 2026 exceed $4.09 million and is limited by taxable income from the active conduct of a business.

Remember, eligible property generally must be placed in service — that is, ready and available for its intended use — by year end to qualify for bonus depreciation or a Sec. 179 expensing election for 2026. Merely purchasing, ordering or paying for property isn't enough.

## Benefits of repair treatment

Even when a capital improvement qualifies for a full first-year deduction, repair treatment isn't interchangeable with bonus depreciation or Sec. 179 treatment. When an expenditure meets the requirements for repair treatment, properly classifying it as a deductible repair (rather than grouping it with capital improvements) may be advantageous for several reasons:

- Repair costs don't have to meet the eligibility or placed-in-service requirements for bonus depreciation.
- Repair deductions aren't subject to the Sec. 179 limits.
- Repair treatment generally avoids depreciation elections, related basis tracking and potential depreciation recapture consequences when the property is sold.

In addition, some states don't fully conform to the federal bonus depreciation or Sec. 179 rules. So, when applicable, repair treatment may provide an earlier state tax deduction. If an improvement qualifies for neither bonus depreciation nor Sec. 179, you may have to depreciate its cost over the applicable recovery period, which could be as long as 39 years.

**Year-end planning**

Now is a good time to review your property-related expenditures in 2026 to determine whether they've been classified correctly and whether any safe harbors or immediate deduction provisions apply. You may also be considering additional purchases or improvements to reduce your current-year taxable income. Contact us for help classifying your 2026 expenditures and evaluating the potential tax benefits of planned purchases or improvements before year end.