Basically the IRS has clarified and defined what constitutes deductible Materials & Supplies and Repairs & Maintenance as it applies to both equipment/tangible personal property, and buildings/real property, as well as dispositions of tangible property. They have also required each company to have policies & procedures in place to determine what needs to be capitalized/depreciated and what can be expensed. Below is a brief summary of each category and the procedures the IRS is now applying to each in order to determine whether amounts can be deducted/expensed. The IRS often references a **<u>Unit of Property</u>**, and defines such as "**functionally interdependent components.**" However, special rules apply to buildings, network assets, plant property, & leased property. Please keep in mind this is not meant to be an all-inclusive list, but rather a very brief overview.

- **<u>Materials & Supplies</u>**
  - Unit of property less than or equal to $200 per item, or according to your specific capitalization policy, can be directly expensed (see attached.)
  - Expected to be used or consumed in 12 months or less (Including fuel, lubricants, etc)
- **<u>Repairs & Maintenance for Tangible Personal Property (Equipment, Autos, etc.)</u>**
  - Unit of property less than or equal to $500 per item, or according to your specific capitalization policy, can be directly expensed (see attached).
  - The repair is expected to occur more than once during the class life (generally 5-6 years for most equipment, and 10 years for office furniture/fixtures)
  - The repair does not fall into one of the following category of improvements:
    - **<u>Betterment</u>** - Does not correct a material condition or defect; **<u>or</u>** is not a material addition (33%) to the unit of property (equipment/auto); **<u>or</u>** does not materially increases productivity, efficiency, strength, quality, or output
    - **<u>Restoration</u>** - Does not replace a unit of property that was sold/exchanged, or lost; **<u>or</u>** does not return the Unit of Property to a like-new condition after the end of the class life referenced above & in the attachment; **<u>or</u>** does not return the unit of property to it's ordinary, efficient, operating condition if it has deteriorated to a state of disrepair and is no longer functional for its intended use; **<u>or</u>** does not replace a part or combination of parts that encompass a major component of the unit of property
    - **<u>Adaptation</u>** - Does not change the unit of property to a new or different use as originally intended
- **<u>Repairs & Maintenance for Real Property (Buildings, Leasehold Improvements, etc.)</u>**
  - A building & its structural components are considered one Unit of Property, however improvement standards must be applied separately to the structure and/or building systems (listed below)
  - The betterment, restoration, and adaptation rules for equipment improvements above also apply to buildings, however additional criteria are provided to assist in determining materiality
  - All expenditures and/or plans of improvement less than the amounts below are considered repair & maintenance expenses:
    - Amount paid does not exceed $10,000 or 2% of original cost of building (eligible bldg & qualifying taxpayer)
    - The repair/improvement is expected to occur more than once in a 10 year period
    - Adding additional square footage less than 5%; Addition to building structures or systems of 10% or less
    - Efficiency increased to building structure or systems of 30% or less
    - Replacement of any building structure or system of 33% or less
    - Below are examples of the building structures or systems
      - Heating, Ventilation, HVAC, Plumbing Systems, Electrical Systems, Elevators/Escalators, Fire Protection/Alarm/Security Systems, Gas Distribution Systems, or any other significant building component

In closing, we realize these new regulations are complex and require additional analysis of your specific business activities for 2014. We hope this summary and the attached documents assist in providing a basic understanding for us to implement these rules together.