



AN ALERT FROM SMITH LEONARD PLLC:

De Minimis Safe Harbor Raised From \$500 to \$2,500



Subject: CAPITALIZATION REGS' DE MINIMIS SAFE HARBOR FOR TAXPAYERS WITH NO AFS RAISED TO \$2,500

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INTRODUCTION

The IRS has announced an increase, from \$500 to \$2,500, in the de minimis safe harbor limit for taxpayers that don't maintain an applicable financial statement (AFS). According to IRS, this change will simplify the paperwork and recordkeeping requirements for small business and other taxpayers.

Background: The final tangible property regs issued in 2013 generally provide that, unless rules allowing the deduction of certain materials and supplies apply, a taxpayer must capitalize amounts paid to acquire or produce a unit of property (UOP), whether real or personal property, including leasehold improvement property, land and land improvements, buildings, machinery and equipment, and furniture and fixtures.

As an alternative to the general capitalization rule, the final regs permit businesses to elect to expense their outlays for “de minimis” business expenses. If the taxpayer is eligible for the de minimis safe harbor election, and chooses it, an amount paid to acquire or produce any eligible UOP (or any eligible material or supply) is deducted in the year paid or incurred.

The de minimis safe harbor applies to an amount paid during the tax year to acquire or produce a UOP, or acquire a material or supply, only if:

- a. The taxpayer has, at the beginning of the tax year, written accounting procedures treating as an expense for non-tax purposes amounts paid for property (1) costing less than a specified dollar amount; or (2) with an economic useful life of 12 months or less.
- b. The taxpayer treats the amount paid for the property as an expense on its AFS (such as a financial statement required to be filed with the Securities and Exchange Commission, or a certified audited financial statement accompanied by an independent CPA's report and used for credit or reporting purposes) if it has one – or on its books and records if it does not – in accordance with its accounting procedures.
- c. If the taxpayer has an AFS, the amount paid for the property does not exceed \$5,000 per invoice (or per item as substantiated by the invoice), or if the taxpayer does not have an AFS, does not exceed \$500 per invoice (or per item as substantiated by the invoice), *or other amount as identified in published IRS guidance.*

The de minimis safe harbor was intended as an administrative convenience to permit a taxpayer to deduct small dollar expenditures for the acquisition or production of new property, or for the improvement of existing property, which otherwise must be capitalized. It does not limit a taxpayer's ability to deduct otherwise deductible repair or maintenance costs that exceed the amount subject to the safe harbor—a taxpayer may continue to deduct all



otherwise deductible repair or maintenance costs, regardless of amounts—but merely establishes a minimum threshold below which all qualifying amounts are considered deductible.

Comments received: After issuing the final tangible property regs, and in response to a formal request for comments on whether the limit should be raised for taxpayers without an AFS, IRS received numerous requests for the limit to be raised with suggested amounts ranging from \$750 to \$100,000. The general sentiment was that the \$500 limit was too low to effectively reduce the administrative burden of complying with the capitalization requirement for small business taxpayers that frequently purchase tangible property in their trades and businesses. Specifically, many commonly expensed items like tablets and smart phones individually exceed the \$500 threshold. Commenters also expressed concern about the disparate treatment of taxpayers with and without an AFS under the safe harbor (\$5,000 vs. \$500), noting that obtaining an AFS is cost-prohibitive for many small businesses and doesn't adequately justify the significantly lower limit.

Threshold raised: In light of comments received and the goal of reducing administrative burdens, IRS has increased the de minimis safe harbor limitation for a taxpayer without an AFS from \$500 to \$2,500. (The limit for taxpayers with an AFS remains at \$5,000.)

Effective date/audit protection: This increase is effective for costs incurred during tax years beginning on or after Jan. 1, 2016, but use of the new threshold won't be challenged in tax years prior to 2016. And, if a taxpayer's use of the de minimis safe harbor is an issue under consideration in examination, appeals, or before the U.S. Tax Court in a tax year beginning after Dec. 31, 2011 and ending before Jan. 1, 2016, and the issue relates to the qualification under the safe harbor of an amount that doesn't exceed \$2,500 per invoice (or item, as substantiated by invoice) and the taxpayer otherwise satisfies the applicable requirements, IRS won't pursue the issue further.

References: For de minimis safe harbor election allowing deduction for amounts paid to acquire or produce property, see *FTC 2d/FIN ¶ L-5601.5* ; *United States Tax Reporter ¶ 2634.01* ; *TaxDesk ¶ 256,201.2C* ; *TG ¶ 16074*