

Reg. Section 1.263(a)-2T

Amounts paid to acquire or produce tangible property (temporary).

(a) Overview. This section provides rules for applying section 263(a) to amounts paid to acquire or produce a unit of real or personal property. Paragraph (b) of this section contains definitions. Paragraph (c) of this section contains the rules for coordinating this section with other provisions of the Internal Revenue Code. Paragraph (d) of this section provides the general requirement to capitalize amounts paid to acquire or produce a unit of real or personal property. Paragraph (e) of this section provides the requirement to capitalize amounts paid to defend or perfect title to real or personal property. Paragraph (f) of this section provides the rules for determining the extent to which taxpayers must capitalize transaction costs related to the acquisition of property. Paragraph (g) of this section provides a de minimis rule for certain amounts paid for the acquisition or production of property. Paragraphs (h) and (i) of this section address the treatment and recovery of capital expenditures. Paragraph (j) of this section provides for changes in methods of accounting to comply with this section, and paragraphs (k) and (l) of this section provide the effective, applicability, and expiration dates for the rules under this section.

(b) Definitions. For purposes of this section, the following definitions apply:

(1) Amount paid. In the case of a taxpayer using an accrual method of accounting, the terms amount paid and payment mean a liability incurred (within the meaning of § 1.446-1(c)(1)(ii)). A liability may not be taken into account under this section prior to the taxable year during which the liability is incurred.

(2) Personal property means tangible personal property as defined in § 1.48-1(c).

(3) Real property means land and improvements thereto, such as buildings or other inherently permanent structures (including items that are structural components of the buildings or structures) that are not personal property as defined in paragraph (b)(2) of this section. Any property that constitutes other tangible property under § 1.48-1(d) is treated as real property for purposes of this section. Local law is not controlling in determining whether property is real property for purposes of this section.

(4) Produce means construct, build, install, manufacture, develop, create, raise, or grow. This definition is intended to have the same meaning as the definition used for purposes of section 263A(g)(1) and § 1.263A-2(a)(1)(i), except that improvements are excluded from the definition in this paragraph (b)(4) and are separately defined and addressed in § 1.263(a)-3T.

(c) Coordination with other provisions of the Internal Revenue Code --(1) In general. Except as provided under the de minimis rule in paragraph (g) of this section, nothing in this section changes the treatment of any amount that is specifically provided for under any provision of the Internal Revenue Code or regulations thereunder other than section 162(a) or section 212 and the regulations under those sections. For example, see section 263A requiring taxpayers to capitalize the direct and indirect costs of producing property or acquiring property for resale. See also section 195 requiring taxpayers to capitalize certain costs as start-up expenditures.

(2) Materials and supplies. Except as provided under the de minimis rule in paragraph (g) of this section, nothing in this section changes the treatment of amounts paid to acquire or produce property that is properly treated as materials and supplies under § 1.162-3T.

(d) Acquired or produced tangible property --(1) Requirement to capitalize. Except as provided in paragraph (g) of this section (providing the de minimis rule) and in § 1.162-3T (relating to materials and supplies), a taxpayer must capitalize amounts paid to acquire or produce a unit of real or personal property (as determined under § 1.263(a)-3T(e)), including leasehold improvement property, land and land improvements, buildings, machinery and equipment, and furniture and fixtures. Amounts paid to acquire or produce a unit of real or personal property include the invoice price, transaction costs as determined under paragraph (f) of this section, and costs for work performed prior to the date that the unit of property is placed in service by the taxpayer (without regard to any applicable convention under section 168(d)). A taxpayer also must capitalize amounts paid to acquire real or personal property for resale and to produce real or personal property. See section 263A for the costs required to be capitalized to property produced by the taxpayer or to property acquired for resale.

(2) Examples. The rules of this section are illustrated by the following examples, in which it is assumed that the taxpayer does not apply the de minimis rule under paragraph (g) of this section:

Example 1. Acquisition of personal property.

X purchases new cash registers for use in its retail store located in leased space in a shopping mall. Assume each cash register is a unit of property as determined under § 1.263(a)-3T(e) and is not a material or supply under § 1.162-3T. X must capitalize under this paragraph (d)(1) the amount paid to acquire each cash register.

Example 2. Acquisition of personal property that is a material or supply; coordination with § 1.162-3T.

X operates a fleet of aircraft. In Year 1, X acquires a stock of component parts, which it intends to use to maintain and repair its aircraft. X does not make elections under § 1.162-3T(d) to treat the materials and supplies as capital expenditures. In Year 2, X uses the component parts in the repair and maintenance of its aircraft. Because the parts are materials and supplies under § 1.162-3T, X is not required to capitalize the amounts paid for the parts under this paragraph (d)(1). Rather, X must apply the rules in § 1.162-3T, governing the treatment of materials and supplies, to determine the treatment of these amounts.

Example 3. Acquisition of unit of personal property; coordination with § 1.162-3T.

X operates a rental business that rents out a variety of small individual items to customers (rental items). X maintains a supply of rental items on hand to replace worn or damaged items. X purchases a large quantity of rental items to be used in its business. Assume that each of these rental items is a unit of property under § 1.263(a)-3T(e). Also assume that a portion of the rental items are materials and supplies under § 1.162-3T(c)(1). Under paragraph (d)(1) of this section, X must capitalize the amounts paid for the rental items that are not materials and supplies under § 1.162-3T(c)(1). However, X must apply the rules in § 1.162-3T to determine the treatment of the rental items that are materials and supplies under § 1.162-3T(c)(1).

Example 4. Acquisition or production cost.

X purchases and produces jigs, dies, molds, and patterns for use in the manufacture of X's products. Assume that each of these items is a unit of property as determined under § 1.263(a)-3T(e) and is not a material and supply under § 1.162-3T(c)(1). X is required to capitalize under

paragraph (d)(1) of this section the amounts paid to acquire and produce the jigs, dies, molds, and patterns. See section 263A for the costs required to be capitalized to the property acquired or produced by X.

Example 5. Acquisition of land.

X purchases a parcel of undeveloped real estate. X must capitalize under paragraph (d)(1) of this section the amount paid to acquire the real estate. See paragraph (f) of this section for the treatment of amounts paid to facilitate the acquisition of real property.

Example 6. Acquisition of building.

X purchases a building. X must capitalize under paragraph (d)(1) of this section the amount paid to acquire the building. See paragraph (f) of this section for the treatment of amounts paid to facilitate the acquisition of real property.

Example 7. Acquisition of property for resale and production of property for sale.

X purchases goods for resale and produces other goods for sale. X must capitalize under paragraph (d)(1) of this section the amounts paid to acquire and produce the goods. See section 263A for the costs required to be capitalized to the property produced or property acquired for resale.

Example 8. Production of building.

X constructs a building. X must capitalize under paragraph (d)(1) of this section the amount paid to construct the building. See section 263A for the costs required to be capitalized to the real property produced by X.

Example 9. Acquisition of assets constituting a trade or business.

Y owns tangible and intangible assets that constitute a trade or business. X purchases all the assets of Y in a taxable transaction. X must capitalize under paragraph (d)(1) of this section the amount paid for the tangible assets of Y. See § 1.263(a)-4 for the treatment of amounts paid to acquire intangibles and § 1.263(a)-5 for the treatment of amounts paid to facilitate the acquisition of assets that constitute a trade or business. See section 1060 for special allocation rules for certain asset acquisitions.

Example 10. Work performed prior to placing the property in service.

In Year 1, X purchases a building for use as a business office. Prior to placing the building in service, X incurs costs to repair cement steps, refinish wood floors, patch holes in walls, and paint the interiors and exteriors of the building. In Year 2, X places the building in service and begins using the building as its business office. Assume that the work that X performs does not constitute an improvement to the building or its structural components under § 1.263(a)-3T. Under § 1.263-3T(e)(2)(i), the building and its structural components is a single unit of property. Under paragraph (d)(1) of this section, the amounts paid must be capitalized as costs of acquiring the building because they were for work performed prior to X's placing the building in service.

Example 11. Work performed prior to placing the property in service.

In January Year 1, X purchases a new machine for use in an existing production line of its manufacturing business. Assume that the machine is a unit of property under § 1.263(a)-3T(e) and is not a material or supply under § 1.162-3T. After the machine is installed, X performs a critical test on the machine to ensure that it will operate in accordance with quality standards. On November 1, Year 1, the critical test is complete, and X places the machine in service on the production line. X performs periodic quality control testing after the machine is placed in

service. Under paragraph (d)(1) of this section, the amounts paid for the installation and the critical test performed before the machine is placed in service must be capitalized as costs of acquiring the machine. However, amounts paid for periodic quality control testing after X placed the machine in service are not required to be capitalized as a cost of acquiring the machine.

(e) Defense or perfection of title to property --(1) In general. Amounts paid to defend or perfect title to real or personal property are amounts paid to acquire or produce property within the meaning of this section and must be capitalized. See section 263A for the costs required to be capitalized to property produced by the taxpayer or to property acquired for resale.

(2) Examples. The following examples illustrate the rule of paragraph (e):

Example 1. Amounts paid to contest condemnation.

X owns real property located in County. County files an eminent domain complaint condemning a portion of X's property to use as a roadway. X hires an attorney to contest the condemnation. The amounts that X paid to the attorney must be capitalized because they were to defend X's title to the property.

Example 2. Amounts paid to invalidate ordinance.

X is in the business of quarrying and supplying for sale sand and stone in a certain municipality. Several years after X establishes its business, the municipality in which it is located passes an ordinance that prohibits the operation of X's business. X incurs attorney's fees in a successful prosecution of a suit to invalidate the municipal ordinance. X prosecutes the suit to preserve its business activities and not to defend X's title in the property. Therefore, the attorney's fees that X paid are not required to be capitalized under paragraph (e)(1) of this section. See section 263A for the rules requiring direct and allocable indirect costs (including otherwise deductible costs) to be capitalized to property produced or property acquired for resale.

Example 3. Amounts paid to challenge building line.

The board of public works of a municipality establishes a building line across X's business property, adversely affecting the value of the property. X incurs legal fees in unsuccessfully litigating the establishment of the building line. The amounts X paid to the attorney must be capitalized because they were to defend X's title to the property.

(f) Transaction costs --(1) In general. A taxpayer must capitalize amounts paid to facilitate the acquisition or production of real or personal property. See section 263A for the costs required to be capitalized to property produced by the taxpayer or to property acquired for resale. See § 1.263(a)-5 for the treatment of amounts paid to facilitate the acquisition of assets that constitute a trade or business. See § 1.167(a)-5 for allocations of facilitative costs between depreciable and non-depreciable property.

(2) Scope of facilitate --(i) In general. Except as otherwise provided in this section, an amount is paid to facilitate the acquisition of real or personal property if the amount is paid in the process of investigating or otherwise pursuing the acquisition. Whether an amount is paid in the process of investigating or otherwise pursuing the acquisition is determined based on all of the facts and circumstances. In determining whether an amount is paid to facilitate an acquisition, the fact that the amount would (or would not) have been paid but for the acquisition is relevant but is not determinative. Amounts paid to facilitate an acquisition include, but are not limited to, inherently facilitative amounts specified in paragraph (f)(2)(ii) of this section.

(ii) Inherently facilitative amounts. An amount is paid in the process of investigating or otherwise pursuing the acquisition of real or personal property if the amount is inherently facilitative. An amount is inherently facilitative if the amount is paid for--

(A) Transporting the property (for example, shipping fees and moving costs);

(B) Securing an appraisal or determining the value or price of property;

(C) Negotiating the terms or structure of the acquisition and obtaining tax advice on the acquisition;

(D) Application fees, bidding costs, or similar expenses;

(E) Preparing and reviewing the documents that effectuate the acquisition of the property (for example, preparing the bid, offer, sales contract, or purchase agreement);

(F) Examining and evaluating the title of property;

(G) Obtaining regulatory approval of the acquisition or securing permits related to the acquisition, including application fees;

(H) Conveying property between the parties, including sales and transfer taxes, and title registration costs;

(I) Finders' fees or brokers' commissions, including amounts paid that are contingent on the successful closing of the acquisition;

(J) Architectural, geological, engineering, environmental, or inspection services pertaining to particular properties; or

(K) Services provided by a qualified intermediary or other facilitator of an exchange under section 1031.

(iii) Special rule for acquisitions of real property --(A) In general. Except as provided in paragraph (f)(2)(ii) of this section (relating to inherently facilitative amounts), an amount paid by the taxpayer in the process of investigating or otherwise pursuing the acquisition of real property does not facilitate the acquisition if it relates to activities performed in the process of determining whether to acquire real property and which real property to acquire.

(B) Acquisitions of real and personal property in a single transaction. An amount paid by the taxpayer in the process of investigating or otherwise pursuing the acquisition of personal property facilitates the acquisition of such personal property even if such property is acquired in a single transaction that also includes the acquisition of real property subject to the special rule set out in paragraph (f)(2)(iii)(A) of this section. A taxpayer may use a reasonable allocation to determine which costs facilitate the acquisition of personal property and which costs relate to the acquisition of real property and are subject to the special rule of paragraph (f)(2)(iii)(A) of this section.

(iv) Employee compensation and overhead costs --(A) In general. For purposes of paragraph (f) of this section, amounts paid for employee compensation (within the meaning of § 1.263(a)-4(e)(4)(ii)) and overhead are treated as amounts that do not facilitate the acquisition of real or personal property. See section 263A, however, for the treatment of employee compensation and overhead costs required to be capitalized to property produced by the taxpayer or to property acquired for resale.

(B) Election to capitalize. A taxpayer may elect to treat amounts paid for employee compensation or overhead as amounts that facilitate the acquisition of property. The election is made separately for each acquisition and applies to employee compensation or overhead, or both.

For example, a taxpayer may elect to treat overhead, but not employee compensation, as amounts that facilitate the acquisition of property. A taxpayer makes the election by treating the amounts to which the election applies as amounts that facilitate the acquisition in the taxpayer's timely filed original Federal income tax return (including extensions) for the taxable year during which the amounts are paid. In the case of an S corporation or a partnership, the election is made by the S corporation or by the partnership, and not by the shareholders or partners. A taxpayer may revoke an election made under this paragraph (f)(2)(iv)(B) with respect to each acquisition only by filing a request for a private letter ruling and obtaining the Commissioner's consent to revoke the election. The Commissioner may grant a request to revoke this election if the taxpayer can demonstrate good cause for the revocation. An election may not be made or revoked through the filing of an application for change in accounting method or, before obtaining the Commissioner's consent to make the late election or to revoke the election, by filing an amended Federal income tax return.

(3) Treatment of transaction costs --(i) In general. All amounts paid to facilitate the acquisition or production of real or personal property are capital expenditures. Facilitative amounts allocable to real or personal property must be included in the basis of the property acquired or produced.

(ii) Treatment of inherently facilitative amounts. Inherently facilitative amounts allocable to real or personal property are capital expenditures related to such property even if the property is not eventually acquired or produced. Inherently facilitative amounts allocable to real or personal property not acquired may be allocated to those properties and recovered as appropriate in accordance with the applicable provisions of the Internal Revenue Code and the regulations thereunder (for example, sections 165, 167, or 168). See paragraph (i) of this section for the recovery of capitalized amounts.

(4) Examples. The following examples illustrate the rules of paragraph (f) of this section:

Example 1. Broker's fees to facilitate an acquisition.

X decides to purchase a building in which to relocate its offices and hires a real estate broker to find a suitable building. X pays fees to the broker to find property for X to acquire. Under paragraph (f)(2)(ii)(I) of this section, X must capitalize the amounts paid to the broker because these costs are inherently facilitative of the acquisition of real property.

Example 2. Inspection and survey costs to facilitate an acquisition.

X decides to purchase building A and pays amounts to third-party contractors for a termite inspection and an environmental survey of building A. Under paragraph (f)(2)(ii)(J) of this section, X must capitalize the amounts paid for the inspection and the survey of the building because these costs are inherently facilitative of the acquisition of real property.

Example 3. Moving costs to facilitate an acquisition.

X purchases all the assets of Y and, in connection with the purchase, hires a transportation company to move storage tanks from Y's plant to X's plant. Under paragraph (f)(2)(ii)(A) of this section, X must capitalize the amount paid to move the storage tanks from Y's plant to X's plant because this cost is inherently facilitative to the acquisition of personal property.

Example 4. Geological and geophysical costs; coordination with other provisions.

X is in the business of exploring, purchasing, and developing properties in the United States for the production of oil and gas. X considers acquiring a particular property but first incurs costs for the services of an engineering firm to perform geological and geophysical studies to

determine if the property is suitable for oil or gas production. Assume that the amounts that X paid to the engineering firm constitute geological and geophysical expenditures under section 167(h). Although the amounts that X paid for the geological and geophysical services are inherently facilitative to the acquisition of real property under paragraph (f)(2)(ii)(J) of this section, X is not required to include those amounts in the basis of the real property acquired. Rather, under paragraph (c) of this section, X must capitalize these costs separately and amortize such costs as required under section 167(h) (addressing the amortization of geological and geophysical expenditures).

Example 5. Scope of facilitate.

X is in the business of providing legal services to clients. X is interested in acquiring a new conference table for its office. X hires and incurs fees for an interior designer to shop for, evaluate, and make recommendations to X regarding which new table to acquire. Under paragraphs (f)(1) and (2) of this section, X must capitalize the amounts paid to the interior designer to provide these services because they are paid in the process of investigating or otherwise pursuing the acquisition of personal property.

Example 6. Transaction costs allocable to multiple properties.

X, a retailer, wants to acquire land for the purpose of building a new distribution facility for its products. X considers various properties on highway A in state B. X incurs fees for the services of an architect to advise and evaluate the suitability of the sites for the type of facility that X intends to construct on the selected site. X must capitalize the architect fees as amounts paid to acquire land because these amounts are inherently facilitative to the acquisition of land under paragraph (f)(2)(ii)(J) of this section.

Example 7. Transaction costs allocable to multiple properties.

X, a retailer, wants to acquire land for the purpose of building a new distribution facility for its products. X considers various properties on highway A in state B. X incurs fees for the services of an architect to prepare preliminary floor plans for a building that X could construct at any of the sites. Under these facts, the architect's fees are not inherently facilitative to the acquisition of land under paragraph (f)(2)(iii)(J) of this section but are allocable as construction costs of the building under section 263A. Therefore, X does not capitalize the architect fees as amounts paid to acquire land but instead must capitalize these costs as indirect costs allocable to the production of property under section 263A.

Example 8. Special rule for acquisitions of real property.

X owns several retail stores. X decides to examine the feasibility of opening a new store in city A. In October, Year 1, X hires and incurs costs for a development consulting firm to study city A and perform market surveys, evaluate zoning and environmental requirements, and make preliminary reports and recommendations as to areas that X should consider for purposes of locating a new store. In December, Year 1, X continues to consider whether to purchase real property in city A and which property to acquire. X hires, and incurs fees for, an appraiser to perform appraisals on two different sites to determine a fair offering price for each site. In March, Year 2, X decides to acquire one of these two sites for the location of its new store. At the same time, X determines not to acquire the other site. Under paragraph (f)(2)(iii) of this section, X is not required to capitalize amounts paid to the development consultant in Year 1 because the amounts relate to activities performed in the process of determining whether to acquire real property and which real property to acquire and the amounts are not inherently facilitative costs under paragraph (f)(2)(ii) of this section. However, X must capitalize amounts paid to the appraiser in Year 1 because the appraisal costs are inherently facilitative costs under

paragraph (f)(2)(ii)(B) of this section. In Year 2, X must include the appraisal costs allocable to property acquired in the basis of the property acquired and may recover the appraisal costs allocable to the property not acquired in accordance with paragraphs (f)(3)(ii) and (i) of this section.

Example 9. Employee compensation and overhead.

X, a freight carrier, maintains an acquisition department whose sole function is to arrange for the purchase of vehicles and aircraft from manufacturers or other parties to be used in its freight carrying business. As provided in paragraph (f)(2)(iv)(A) of this section, X is not required to capitalize any portion of the compensation paid to employees in its acquisition department or any portion of its overhead allocable to its acquisition department. However, under paragraph (f)(2)(iv)(B) of this section, X may elect to capitalize the compensation and overhead costs allocable to the acquisition of a vehicle or aircraft by treating these amounts as costs that facilitate the acquisition of that property in its timely filed original federal income tax return for the year the amounts are paid.

(g) De minimis rule --(1) In general. Except as otherwise provided in this paragraph (g), a taxpayer is not required to capitalize under paragraph (d)(1) of this section nor treat as a material or supply under § 1.162-3T(a) amounts paid for the acquisition or production (including any amounts paid to facilitate the acquisition or production) of a unit of property (as determined under § 1.263(a)-3T(e)) or for the acquisition or production of any material or supply (as defined in § 1.162-3T(c)(1)) if--

(i) The taxpayer has an applicable financial statement (as defined in paragraph (g)(6) of this section);

(ii) The taxpayer has at the beginning of the taxable year written accounting procedures treating as an expense for non-tax purposes the amounts paid for property costing less than a certain dollar amount;

(iii) The taxpayer treats the amounts paid during the taxable year as an expense on its applicable financial statement in accordance with its written accounting procedures; and

(iv) The total aggregate of amounts paid and not capitalized under paragraph (g)(1) of this section and § 1.162-3T(f) (materials and supplies) for the taxable year are less than or equal to the greater of--

(A) 0.1 percent of the taxpayer's gross receipts for the taxable year as determined for Federal income tax purposes; or

(B) 2 percent of the taxpayer's total depreciation and amortization expense for the taxable year as determined in its applicable financial statement.

(2) Exceptions to de minimis rule. The de minimis rule in paragraph (g)(1) of this section does not apply to the following:

(i) Amounts paid for property that is or is intended to be included in inventory property; and

(ii) Amounts paid for land.

(3) Additional rules. Property to which a taxpayer applies the de minimis rule contained in paragraph (g) of this section is not treated upon sale or other disposition as a capital asset under section 1221 or as property used in the trade or business under section 1231. The cost of property to which a taxpayer properly applies the de minimis rule contained in paragraph (g) of this section is not required to be capitalized under section 263A to a separate unit of property but

may be required to be capitalized as a cost of other property if incurred by reason of the production of the other property. See, for example, § 1.263A-1(e)(3)(ii)(R) requiring taxpayers to capitalize the cost of tools and equipment allocable to property produced or property acquired for resale.

(4) Election to capitalize. A taxpayer may elect not to apply the de minimis rule contained in paragraph (g)(1) of this section. An election made under this paragraph (g)(4) may apply to any unit of property during the taxable year to which paragraph (g)(1) of this section would apply (but for the election under this paragraph (g)(4)). A taxpayer makes the election by capitalizing the amounts paid to acquire or produce the unit of property in the taxable year the amounts are paid and by beginning to recover the costs when the unit of property is placed in service by the taxpayer for the purposes of determining depreciation under the applicable provisions of the Internal Revenue Code and the regulations thereunder. A taxpayer must make this election on its timely filed original Federal income tax return (including extensions) for the taxable year the unit of property is placed in service by the taxpayer for the purposes of determining depreciation. In the case of an S corporation or a partnership, the election is made by the S corporation or by the partnership, and not by the shareholders or partners. A taxpayer may revoke an election made under this paragraph (g)(4) with respect to a unit of property only by filing a request for a private letter ruling and obtaining the Commissioner's consent to revoke the election. The Commissioner may grant a request to revoke this election if the taxpayer can demonstrate good cause for the revocation. An election may not be made or revoked through the filing of an application for change in accounting method or by filing an amended Federal income tax return.

(5) Materials and supplies. A taxpayer must treat amounts paid to acquire or produce a unit of property that is a material or supply as defined under § 1.162-3T(c)(1) under § 1.162-3T unless the taxpayer elects under § 1.162-3T(f) to apply the de minimis rule to that property under this paragraph (g). Property to which a taxpayer applies the de minimis rule contained in paragraph (g) of this section is not treated as a material or supply under § 1.162-3T.

(6) Definition of applicable financial statement. For purposes of this section (g), the taxpayer's applicable financial statement is the taxpayer's financial statement listed in paragraphs (g)(6)(i) through (iii) of this section that has the highest priority (including within paragraph (g)(6)(ii) of this section). The financial statements are, in descending priority--

(i) A financial statement required to be filed with the Securities and Exchange Commission (SEC) (the 10-K or the Annual Statement to Shareholders);

(ii) A certified audited financial statement that is accompanied by the report of an independent CPA (or in the case of a foreign entity, by the report of a similarly qualified independent professional), that is used for--

(A) Credit purposes;

(B) Reporting to shareholders, partners, or similar persons; or

(C) Any other substantial non-tax purpose; or

(iii) A financial statement (other than a tax return) required to be provided to the federal or a state government or any federal or state agencies (other than the SEC or the Internal Revenue Service).

(7) Application to consolidated group member. If the taxpayer is a member of a consolidated group for federal income tax purposes and the member's financial results are reported on the applicable financial statement (as defined in paragraph (g)(6) of this section) for the consolidated group then, for purposes of paragraphs (g)(1)(ii) and (g)(1)(iii) of this section, the written

accounting procedures provided for the group and utilized for the group's applicable financial statement may be treated as the written accounting procedures of the member.

(8) Examples. The following examples illustrate the rule of this paragraph (g):

Example 1. De minimis rule.

X purchases 10 printers at \$ 200 each for a total cost of \$ 2,000. Assume that each printer is a unit of property under § 1.263(a)-3T(e) and is not a material or supply under § 1.162-3T. X has an applicable financial statement and a written policy at the beginning of the taxable year to expense amounts paid for property costing less than \$ 500. X treats the amounts paid for the printers as an expense on its applicable financial statement. Assume that the total aggregate amounts treated as de minimis and not capitalized by X under paragraphs (g)(1)(i), (ii), and (iii) of this section, including the amounts paid for the printers, are less than or equal to the greater of 0.1 percent of total gross receipts or 2 percent of X's total financial statement depreciation under paragraph (g)(1)(iv) of this section. X is not required to capitalize the amounts paid for the 10 printers under paragraph (g)(1) of this section.

Example 2. De minimis rule not met.

X is a member of a consolidated group for federal income tax purposes. X's financial results are reported on the consolidated applicable financial statements for the affiliated group. X's affiliated group has a written policy at the beginning of Year 1, which is followed by X, to expense amounts paid for property costing less than \$ 500. In Year 1, X pays \$ 160,000 to purchase 400 computers at \$ 400 each. Assume that each computer is a unit of property under § 1.263(a)-3T(e), is not a material or supply under § 1.162-3T, and that X intends to treat the cost of only the computers as de minimis under paragraph (g)(1) of this section. X treats the amounts paid for the computers as an expense on the applicable financial statements for the affiliated group. For its Year 1 taxable year, X has gross receipts of \$ 125,000,000 for Federal tax purposes and reports \$ 7,000,000 of its own depreciation and amortization expense on the affiliated group's applicable financial statement. Thus, in order to meet the criteria of paragraph (g)(1)(iv) of this section for Year 1, the total aggregate amounts paid and not capitalized by X under paragraphs (g)(1)(i), (ii), and (iii) of this section must be less than or equal to the greater of \$ 125,000 (0.1 percent of X's total gross receipts of \$ 125,000,000) or \$ 140,000 (2 percent of X's total depreciation and amortization of \$ 7,000,000). Because X pays \$ 160,000 for the computers and this amount exceeds \$ 140,000, the greater of the two limitations provided in paragraph (g)(1)(iv) of this section, X may not apply the de minimis rule under paragraph (g)(1) of this section to the total amounts paid for the 400 computers.

Example 3. De minimis rule; election to capitalize.

Assume the same facts as in Example 2, except that X makes an election under paragraph (g)(4) of this section to capitalize \$ 20,000, the amounts paid to acquire 50 of the 400 computers purchased in Year 1. Under these facts, the \$ 140,000 paid by X in Year 1 for the remaining 350 computers qualifies for the de minimis rule under paragraph (g)(1) of this section because this amount is equal to 2 percent of X's total depreciation (\$ 140,000), the greater of the two amounts calculated under paragraph (g)(1)(iv) of this section. Accordingly, X is not required to capitalize the amounts paid to acquire the 350 computers in Year 1.

Example 4. Election to apply de minimis rule to certain materials and supplies.

(i) X is a corporation that provides consulting services to its customers. X has an applicable financial statement and a written policy at the beginning of the taxable year to expense amounts paid for property costing \$ 500 or less. In Year 1, X purchases 200 computers at \$ 500 each for a

total cost of \$ 100,000. Assume that each computer is a unit of property under § 1.263(a)-3T(e) and is not a material or supply under § 1.162-3T. In addition, X purchases 200 office chairs at \$ 100 each for a total cost of \$ 20,000 and 250 customized briefcases at \$ 80 each for a total cost of \$ 20,000. Assume that each office chair and each briefcase is a material or supply under § 1.162-3T(c)(1). In Year 1, X also acquires 10 books at \$ 100 each, which are also materials and supplies under § 1.162-3T(c)(1). X makes the election under § 1.162-3T(f) to apply the de minimis rule to the office chairs and briefcases, but does not make that election for the books and treats the books as materials and supplies in accordance with the provisions of § 1.162-3T. X treats the amounts paid for the computers, office chairs, and briefcases as expenses on its applicable financial statement. Assume also that for Year 1, the amounts that X paid for the computers, office chairs, and briefcases are the only amounts that X intends to treat as de minimis costs not capitalized under paragraph (g)(1) of this section. For its Year 1 taxable year, X has gross receipts of \$ 125,000,000 and reports \$ 7,000,000 of depreciation and amortization on its applicable financial statement.

(ii) In order to meet the requirements of paragraph (g)(1)(iv) of this section for Year 1, X's total aggregate amounts paid and not capitalized under paragraphs (g)(1)(i), (ii), and (iii) of this section must be less than or equal to the greater of \$ 125,000 (0.1 percent of X's total gross receipts of \$ 125,000,000) or \$ 140,000 (2 percent of X's total depreciation and amortization of \$ 7,000,000). X pays a total of \$ 140,000 (\$ 100,000 + \$ 20,000 + \$ 20,000) for the computers, office chairs, and briefcases. X is not required to include the amounts paid for the books in this computation because X has not elected under § 1.162-3T(f) to apply the de minimis rule to the books. Thus, the total aggregate amounts paid and not capitalized under paragraph (g)(1) of this section is equal to \$ 140,000 (2 percent of X's total financial depreciation), the greater of the two limitations set out under paragraph (g)(1)(iv) of this section. Accordingly, under paragraph (g)(1) of this section, in Year 1, X may treat as de minimis and is not required to capitalize the \$ 140,000 paid to acquire the computers, office chairs, and briefcases.

(h) Treatment of capital expenditures. Amounts required to be capitalized under this section are capital expenditures and must be taken into account through a charge to capital account or basis, or in the case of property that is inventory in the hands of a taxpayer, through inclusion in inventory costs. See section 263A for the treatment of direct and certain indirect costs of producing property or acquiring property for resale.

(i) Recovery of capitalized amounts --(1) In general. Amounts that are capitalized under this section are recovered through depreciation, cost of goods sold, or by an adjustment to basis at the time the property is placed in service, sold, used, or otherwise disposed of by the taxpayer. Cost recovery is determined by the applicable provisions of the Internal Revenue Code and regulations relating to the use, sale, or disposition of property.

(2) Examples. The following examples illustrate the rule of paragraph (i)(1) of this section. Assume that X does not apply the de minimis rule under paragraph (g) of this section.

Example 1.

Recovery when property placed in service. X owns a 10-unit apartment building. The refrigerator in one of the apartments stops functioning, and X purchases a new refrigerator to replace the old one. X pays for the acquisition, delivery, and installation of the new refrigerator. Assume that the refrigerator is the unit of property, as determined under § 1.263(a)-3T(e), and is not a material or supply under § 1.162-3T. Under paragraph (d)(1) of this section, X is required to capitalize the amounts paid for the acquisition, delivery, and installation of the refrigerator.

Under paragraph (i) of this section, the capitalized amounts are recovered through depreciation, which begins when the refrigerator is placed in service by X.

Example 2.

Recovery when property used in the production of property. X operates a plant where it manufactures widgets. X purchases a tractor loader to move raw materials into and around the plant for use in the manufacturing process. Assume that the tractor loader is a unit of property, as determined under § 1.263(a)-3T(e), and is not a material or supply under § 1.162-3T. Under paragraph (d)(1) of this section, X is required to capitalize the amounts paid to acquire the tractor loader. Under paragraph (i) of this section, the capitalized amounts are recovered through depreciation, which begins when X places the tractor loader in service. However, because the tractor/loader is used in the production of property, under section 263A the cost recovery (that is, the depreciation) on the capitalized amounts must be capitalized to X's property produced, and, consequently, recovered through cost of goods sold. See § 1.263A-1(e)(3)(ii)(I).

(j) Accounting method changes. Except as otherwise provided in this section, a change to comply with this section is a change in method of accounting to which the provisions of sections 446 and 481, and the regulations thereunder apply. A taxpayer seeking to change to a method of accounting permitted in this section must secure the consent of the Commissioner in accordance with § 1.446-1(e) and follow the administrative procedures issued under § 1.446-1(e)(3)(ii) for obtaining the Commissioner's consent to change its accounting method.

(k) Effective/applicability date. Except for paragraphs (f)(2)(iii), (f)(2)(iv), (f)(3)(ii) and (g) of this section, this section generally applies to taxable years beginning on or after January 1, 2012. Paragraphs (f)(2)(iii), (f)(2)(iv), (f)(3)(ii), and (g) of this section apply to amounts paid or incurred (to acquire or produce property) in taxable years beginning on or after January 1, 2012. For the applicability of regulations to taxable years beginning before January 1, 2012, see § 1.263(a)- in effect prior to January 1, 2012 (§ 1.263(a)-2 as contained in 26 CFR part 1 edition revised as of April 1, 2011).

(l) Expiration Date. The applicability of this section expires on December 23, 2014.