KBKG Repair vs. Capitalization: Improvement Decision Tree - Final Regulations

Considering the appropriate Unit of Property (UOP), does the expenditure:

(Last Updated 3-2-2015)

Correct a material defect/condition that existed before acquisition?

Possibly

No

Materiually increase the capacity, productivity, efficiency, quality, strength, or output?

Possibly

No

Is a material addition?

Possibly

No

Change the use of the property from its intended use when it was placed in service?

Possibly

No

Rebuild the UOP to "like new" condition after the end of its class life (ADS life)?

Possibly

No

Replace a Major Component or Substantial Structural Part?

Possibly

No

Return UOP to ordinary operating condition after deteriorated (in a state of disrepair)?

Possibly

No

Result in a basis adjustment or loss deduction for component removed?

Possibly

No

Was the expenditure "incurred by reason of an improvement" or did it directly benefit an improvement?

Possibly

No

Possible Repair Expense

Even if the defect was not known at the time of acquisition:

Answer = YES

Yes

Particular Event - compare condition of UOP just before event vs. after expenditure

What do you compare against to see if it's a betterment?

Yes

Normal Wear - compare condition just after expenditure vs. last time it was updated or when placed in service

Yes

Example 1. Office is converted to showroom:

Answer = YES

Example 2. Three retail spaces converted to one retail space:

Answer = NO

Yes

If using improved but comparable part due to technology advancing (i.e. impractical to use old type)

Answer = NO

If brought to remanufactured or similar status under federal guidelines or manufacturer original specs.

Answer = YES

Yes

If replacing a large physical portion of UOP. Answer = YES

(Generally, replacing < 33%: Answer = NO)

Yes

Based on "facts and circumstances"

If replacing part that performs discrete & critical function in operation of UOP (ex. such as a central furnace):

Answer = YES

Yes

If minor part breaks during normal use & causes UOP to temporarily cease to function:

Answer = YES

Yes

If basis adjustment due to casualty loss, sale, or exchange of component. Answer = YES.

Yes

Was it done in conjunction or at the same time as an improvement to a UOP?

Yes

Was the cost necessary or critical to complete the associated improvement.

Yes
KBKG Building Unit of Property & Major Components Chart (updated 3-18-2015)

This chart was created to help users identify building systems & typical "major components" in real estate assets. Replacing a major component is a capital expenditure, while replacing an incidental component can be expensed.

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<tbody>
<tr>
<td>Roof System (membrane, insulation &amp; structural supports)</td>
<td>• Landscaping incl: shrubs, trees, ground cover, lawn, irrigation • Storm drainage incl: inlets, catch basins, piping, lift stations • Site lighting (pole lights, bollard lights, up lights, wiring) • Hardscape (retaining walls, pools, water features) • Site Structures (gazebo, carport, monument sign) • Paving (roads, driveway, parking areas, sidewalks, curbing)</td>
<td>• Heating System (boilers, furnace, radiators) • Cooling System (compressors, chillers, cooling towers) • Rooftop Packaged Units • Air Distribution (Ducts, fans, etc.) • Piping (heated, chilled, condensate water)</td>
<td>• Service &amp; Distribution (panel boards, transformers, switch gear, metering) • Lighting (interior &amp; exterior building mounted) • Site Electrical Utilities • Branch Wiring (outlets, conduit, wire, devices etc.) • Emergency Power Systems</td>
<td>• Plumbing Fixtures (sinks, toilets, tubs etc.) • Wastewater System (drains, waste &amp; vent piping) • Domestic Water (supply piping and fittings) • Water Heater • Site Piping Utilities</td>
<td>• Sprinkler System (piping, heads, pumps) • Fire Alarms (detection &amp; warning devices, controls) • Exit lighting &amp; signage • Fire Escapes • Extinguishers &amp; hoses</td>
<td>• Building security alarms (detectors, sirens, wiring) • Building access &amp; control System</td>
<td>• Gas piping incl: to/from property line &amp; other Bldgs.</td>
<td>• Stair and Handrail • Drive System (motors, truss, tracks)</td>
<td>• Elevator Car • Drive System (motors, lifts, controls)</td>
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* Building unit of property (UOP) rules apply to each building structure located on a single property.

** Building system components with a different tax life are separate units of property. For example, a cost segregation study separating HVAC into 5 year & 39 year categories for a restaurant creates two separate HVAC units of property.

Lessee of Building
Must apply the same units of property above but only to the portion of the building being leased.

Personal Property
UOP are parts that are "functionally interdependent" i.e. placing one part in service is dependent on placing the other part in service.

Plant Property
UOP is each component that performs a discrete and critical function. Generally each piece of machinery or equipment purchased separately.

Network Assets
UOP is determined by taxpayers particular facts

Definitions

- **Plant Property**: Machinery & equipment used to perform an industrial process such as manufacturing, generation, warehousing, distribution, automated materials handling, or other similar activities.
- **Network Assets**: Railroad track, oil & gas pipelines, water & sewage pipelines, power transmission & distribution lines, telephone & cable lines; -- owned or leased by taxpayers in each of those respective industries.
- **Major Component**: Part or combination of parts that performs a discrete and critical function in the operation of the unit of property
- **Incidental Component**: Relatively small, inexpensive, or minor part that performs a discrete and critical function for the UOP. Generally, not capitalized because of its size, cost, or significance.
- **Examples**: Asphalt sealer, HVAC thermostats, HVAC fan coils, HVAC registers, Plumbing valves and fittings, lighting or power control devices, hardware, escalator handrail, paint, roof shingles.

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