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

Considering the appropriate Unit of Property (UOP), does the expenditure (Last Updated 03-20-2015):

1. Correct a material defect/condition that existed before acquisition?
   - Yes: Possible
   - No:
     - Materially increase the capacity, productivity, efficiency, quality, strength, or output?
       - Yes: Possible
       - No: Is a material addition?
         - Yes: Possible
         - No: Change the use of the property from its intended use when it was placed in service?
           - Yes: Possible
           - No: Rebuild the UOP to "like new" condition after the end of its class life (ADS life)?
             - Yes: Possible
             - No: Replace a Major Component or Substantial Structural Part?
               - Yes: Possible
               - No: Return UOP to ordinary operating condition after deteriorated (in a state of disrepair)?
                 - Yes: Possible
                 - No: Result in a basis adjustment or loss deduction for component removed?
                   - Yes: Possible
                   - No: Was the expenditure "incurred by reason of an improvement" or did it directly benefit an improvement?
                     - Yes: Possible
                     - No: Was it done in conjunction or at the same time as an improvement to a UOP?
                       - Yes: Possible
                       - No: Was the cost necessary or critical to complete the associated improvement.
                         - Yes: Possible
                         - No: What do you compare against to see if it’s a betterment?
                           - Yes: Possible
                           - No: Normal Wear - compare condition just after expenditure vs. last time it was updated or when placed in service.
                             - Yes: Possible
                             - No: Particular Event - compare condition of UOP just before event vs. after expenditure.
                               - Yes: Possible
                               - No: Example 1. Office is converted to showroom. Answer = YES
                                 Example 2. Three retail spaces converted to one retail space. Answer = NO
                                 If there was physical enlargement, expansion, or extension: Answer = YES
                                 If brought to remanufactured or similar status under federal guidelines or manufacturer original specs: Answer = YES
                                 If replacing a large physical portion of UOP: Answer = YES (Generally, replacing < 55%: Answer = NO)
                                 Based on "facts and circumstances":
                                   - Yes: Possible
                                   - No: Replacing only incidental component, even if it affects function of UOP (i.e., such as roof shingles or HVAC switch): Answer = NO
                                     If replacing part that performs discrete & critical function in operation of UOP (ex. such as a central furnace): Answer = YES
                                     If minor part breaks during normal use & causes UOP to temporarily cease to function: Answer = NO
                                       - Yes: Possible
                                       - No: Was the expenditure incurred by reason of an improvement or did it directly benefit an improvement? Answer = YES
                                         - Yes: Possible
                                         - No: Was it done in conjunction or at the same time as an improvement to a UOP? Answer = YES
                                           - Yes: Possible
                                           - No: Possible Repair Expense

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**KBKG Building Unit of Property & Major Components Chart updated 05-16-17**

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</td>
<td>Landscaping</td>
<td>Heating System</td>
<td>Service &amp; Distribution</td>
<td>Plumbing Fixtures</td>
<td>Sprinkler System</td>
<td>Building security alarms</td>
<td>Gas piping including to/ from property line &amp; other buildings</td>
<td>Stair and Handrail</td>
<td>Elevator Car</td>
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<td></td>
<td>(membrane, insulation &amp; structural supports)</td>
<td>(boilers, furnace, radiators)</td>
<td>(panel boards, transformers, switchgear, metering)</td>
<td>(sinks, toilets, tubs etc.)</td>
<td>(piping, heads, pumps)</td>
<td>(detectors, sirens, wiring)</td>
<td>(packaged units)</td>
<td>(motors, lifts, controls)</td>
<td>(motors, truss, tracks)</td>
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<tr>
<td>Foundation</td>
<td>Trees, ground cover, lawn, irrigation</td>
<td>Cooling System (compressors, chillers, cooling towers)</td>
<td>Lighting (interior &amp; exterior building mounted)</td>
<td>Wastewater System (drains, waste &amp; vent piping)</td>
<td>Fire Alarms (detection &amp; warning devices, controls)</td>
<td>Building access &amp; control system</td>
<td>(gas piping)</td>
<td>(drive system)</td>
<td>(counterweights, framing, guide rails)</td>
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<td>Other structural Load Bearing Elements, including stairs</td>
<td>Storm drainage including inlets, catch basins, piping, lift stations</td>
<td>Rooftop Packaged Units</td>
<td>Domestic Water (supply piping and fittings)</td>
<td>Fire Alarms (detection &amp; warning devices, controls)</td>
<td>Exit lighting &amp; signage</td>
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<tr>
<td>Exterior Wall System</td>
<td>Site lighting (pole lights, bollard lights, up lights, wiring)</td>
<td>Air Distribution (Ducts, fans, etc)</td>
<td>Water Heater</td>
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<td>Fire Escapes</td>
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<td>Ceilings</td>
<td>Hard scape (retaining walls, pools, water features)</td>
<td>Site Electrical Utilities</td>
<td>Site Piping Utilities</td>
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<td>Floors</td>
<td>Site Structures (gazebo, carport, monument sign)</td>
<td>Branch Wiring (outlets, conduit, wire, devices etc.)</td>
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<td>Fire Alarms (detection &amp; warning devices, controls)</td>
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<td>Doors</td>
<td>Paving (roads, driveway, parking areas, sidewalks, curbing)</td>
<td>Emergency Power Systems</td>
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<td>Exit lighting &amp; signage</td>
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<td>Windows</td>
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<td>Fire Escapes</td>
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<td>Partitions</td>
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<td>Loading Docks</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 taxpayer’s 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

**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.

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