

Repair or Improvement? Know the Tax Rules

Critical Difference for Owners of Business Buildings

For tax purposes, the difference between a “repair” and an “improvement” is more than just semantics. Generally speaking, the cost of an improvement to a business property must be capitalized and written off over a period of years. In contrast, if you simply repair a business asset, you may currently deduct the entire cost.

Some expenses are clearly improvements. For example, if you pave over vacant land and use it as a parking lot, you will have to capitalize the cost. However, in many other cases, the line between repairs and improvements is not as clear cut. Obviously, it may be in your best interest to have work labeled a repair rather than an improvement.

How Do You Tell the Difference?

Here’s a rule of thumb: An improvement is work that prolongs the life of the property, enhances its value or adapts it to a different use. On the other hand, a repair merely keeps property in efficient operating condition. Let’s take a quick look at a few examples.

Repairs

Generally, the term includes items such as painting and wallpapering, repairing leaks in a roof, patching up cracks in a floor or

replacing a worn out or broken component of an air conditioning system.

Improvements

Replacing an old roof with an entirely new one clearly is an improvement that must be capitalized and depreciated. So is the cost of renovating an entire structure, remodeling a building to suit a different purpose or reconditioning or rebuilding a piece of machinery.

Beware: the Pitfalls

Be aware that there are several tax pitfalls in this area. For instance, a business owner who decides to renovate, remodel or expand a building will often make necessary repairs at the same time. While this makes a good deal of economic sense, it could be a bad idea from a tax viewpoint, as the IRS might argue that the repairs are part of the general betterment or renovation plan. In that case, the entire cost, including the repairs portion, must be capitalized.

One possible solution is to show that the two types of expenses are clearly distinguishable. For example, if an owner puts a new exterior surface on a building and makes interior repairs while the

work is being performed, the repairs should be currently deductible.

Probably the best way to ensure the current deduction is to keep the jobs separate and apart. If possible, you might make all your repairs first. Then, at some later point, you can have the improvements completed.

Effect on Homeowners

In general, the cost of repairs to your home won’t do you any tax good at all. On the other hand, improvements increase your basis in the property. As a result, you can reduce any gain that would be subject to tax if you sell the home.

Therefore, it generally is more advantageous to have a home expense labeled as an improvement instead of a repair – just the opposite of the usual situation for business owners. If you are planning to renovate or remodel your home, you may want to defer any repairs that have to be made until that time and do the entire job at once. ■



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