Proposed Treasury Regulation 1.263(a)-3(e)(1)

Amounts paid to improve tangible property.

(e) Safe harbor for routine maintenance—

(1) In general. An amount paid for routine maintenance performed on a unit of property is deemed to not improve that unit of property. Routine maintenance is the recurring activities that a taxpayer expects to perform as a result of the taxpayer's use of the unit of property to keep the unit of property in its ordinarily efficient operating condition. Routine maintenance activities include, for example, the inspection, cleaning, and testing of the unit of property, and the replacement of parts of the unit of property with comparable and commercially available and reasonable replacement parts. The activities are routine only if, at the time the unit of property is placed in service by the taxpayer, the taxpayer reasonably expects to perform the activities more than once during the class life (as defined in paragraph (e)(4) of this section) of the unit of property. Among the factors to be considered in determining whether a taxpayer is performing routine maintenance are the recurring nature of the activity, industry practice, manufacturers' recommendations, the taxpayer's experience, and the taxpayer's treatment of the activity on its applicable financial statement (as defined in paragraph (b)(4) of this section). With respect to a taxpayer that is a lessor of a unit of property, the taxpayer's use of the unit of property includes the lessee's use of the unit of property.

(2) Exceptions. Routine maintenance does not include the following--

(i) Amounts paid for the replacement of a component of a unit of property if the taxpayer has properly deducted a loss for that component (other than a casualty loss under § 1.165-7);

(ii) Amounts paid for the replacement of a component of a unit of property if the taxpayer has properly taken into account the adjusted basis of the component in realizing gain or loss resulting from the sale or exchange of the component;

(iii) Amounts paid for the repair of damage to a unit of property for which the taxpayer has taken a basis adjustment as a result of a casualty loss under section 165 or relating to a casualty event described in section 165; and

(iv) Amounts paid to return a unit of property to its former ordinarily efficient operating condition, if the property has deteriorated to a state of disrepair and is no longer functional for its intended use.

(3) Rotable or temporary spare parts. For purposes of paragraph (e)(1) of this section, amounts paid for routine maintenance include routine maintenance performed on (and with regard to) rotable and temporary spare parts. But see § 1.162-3(b), which provides that rotable and temporary spare parts are used or consumed by the taxpayer in the taxable year in which the taxpayer disposes of the part.

(4) Class life. The class life of a unit of property is the recovery period prescribed for the property under section 168(g)(2) and (3) for purposes of the alternative depreciation system, regardless of whether the property is depreciated under section 168(g). For purposes of determining class life under this paragraph (e), section 168(g)(3)(A) (relating to tax-exempt use property subject to lease) does not apply.

(5) Examples. The following examples illustrate the rules of this paragraph (e).

Example 1.

Routine maintenance on rotable component.

(i) X is a commercial airline engaged in the business of transporting passengers and freight throughout the United States and abroad. To conduct its business, X owns or leases various types of aircraft. As a condition of maintaining its airworthiness certification for these aircraft, X is required by the Federal Aviation Administration (FAA) to establish and adhere to a continuous maintenance program for each aircraft within its fleet. These programs, which are designed by X and the aircraft's manufacturer and approved by the FAA, are incorporated into each aircraft's maintenance manual. The maintenance manuals require a variety of periodic maintenance visits at various intervals. One type of maintenance visit is an engine shop visit (ESV), which X expects to perform on its aircraft engines approximately every 4 years in order to keep its aircraft in its ordinarily efficient operating condition. In 2004, X purchased a new aircraft and four new engines to use in that aircraft and later, in other aircraft in its fleet. The aircraft engines are rotable spare parts because they are removable from the aircraft, and repaired and reinstalled on other aircraft or stored for later installation on other aircraft. See § 1.162-3(b) (treatment of materials and supplies). In 2008, X performs its first ESV on the aircraft engines. The ESV includes disassembly, cleaning, inspection, repair, replacement, reassembly, and testing of the engine and its component parts. During the ESV, the engine is removed from the aircraft and shipped to an outside vendor who performs the ESV. If inspection or testing discloses a discrepancy in a part's conformity to the specifications in X's maintenance program, the part is repaired, or if necessary, replaced with a comparable and commercially available and reasonable replacement part. After the ESVs the engines are returned to X to be reinstalled on another aircraft or stored for later installation. Assume the unit of property for X's aircraft is the entire aircraft, including the aircraft engines, and that the class life for X's aircraft is 12 years. Assume that none of the exceptions set out in paragraph (e)(2) of this section applies to the costs of performing the ESVs.

(ii) Because the ESVs involve the recurring activities that X expects to perform as a result of its use of the aircraft to keep the aircraft in ordinarily efficient operating condition, and consist of maintenance activities that X expects to perform more than once during the 12 year class life of the aircraft, X's ESVs are within the routine maintenance safe harbor under paragraph (e) of this section. Accordingly, the amounts paid by X for the ESVs are deemed not to improve the aircraft and are not required to be capitalized under paragraph (d)(1) of this section. For the treatment of costs to acquire the engines, see § 1.162-3.

Example 2.

Routine maintenance after economic useful life. Assume the same facts as in Example 1, except that X incurs costs to perform an ESV on one of its aircraft engines in 2024, after the end of the economic useful life that X anticipated for the aircraft. Because this ESV involves the same routine maintenance activities that were performed on aircraft engines in Example 1, this ESV also is within the routine maintenance safe harbor under paragraph (e) of this section. Accordingly, the amounts paid by X for this ESV, even though performed after the economic useful life of the aircraft, are deemed not to improve the aircraft and are not required to be capitalized under paragraph (d)(1) of this section.

Example 3.

Routine maintenance resulting from prior owner's use.

(i) In January 2008, X purchases a used machine for use its manufacturing operations. Assume that the machine is the unit of property and has a class life of 10 years. The machine is fully operational at the time it is purchased by X and is immediately placed in service in X's business. At the time it is placed in service by X, X expects to perform manufacturer recommended scheduled maintenance on the machine approximately every three years. The scheduled maintenance includes the cleaning and oiling of the machine, the inspection of parts for defects, and the replacement of minor items such as springs, bearings, and seals with comparable and commercially available and reasonable replacement parts. At the time the machine is purchased, it is approaching the end of a three-year scheduled maintenance period. As a result, in February 2008, X incurs costs to perform the manufacturer recommended scheduled maintenance. Assume that none of the exceptions set out in paragraph (e)(2) of this section apply to the amounts paid for the scheduled maintenance.

(ii) The majority of the costs incurred by X do not qualify under the routine maintenance safe harbor in paragraph (e) of this section because the costs were primarily incurred as a result of the prior owner's use of the property and not X's use. The condition of the machine at the time that it was placed in service by X was that of a machine nearing the end of a scheduled maintenance period. Accordingly, the amounts paid by X for the scheduled maintenance resulting from the prior owner's use of the property must be capitalized if those amounts result in a betterment under paragraph (f) of this section, including the amelioration of a material condition or defect, or otherwise result in an improvement under paragraph (d)(1) of this section. See also section 263A requiring taxpayers to capitalize the direct and allocable share of indirect costs of property produced or acquired for resale.

Example 4.

Routine maintenance resulting from new owner's use. Assume the same facts as in Example 3, except that after X incurs costs for the maintenance in 2008, X continues to operate the machine in its manufacturing business. In 2011, X incurs costs to perform the next scheduled manufacturer recommended maintenance on the machine. Assume that the scheduled maintenance activities performed are the same as those performed in Example 3 and that none of the exceptions set out in paragraph (e)(2) of this section apply to the amounts paid for the scheduled maintenance. Because the scheduled maintenance performed in 2011 involves the recurring activities that X performs as a result of its use of the machine, keeps the machine in an ordinarily efficient operating condition, and consists of maintenance activities that X expects to perform more than once during the 10 year class life of the machine, X's scheduled maintenance costs are within the routine maintenance safe harbor under paragraph (e) of this section. Accordingly, the amounts paid by X for the scheduled maintenance in 2011 are deemed not to improve the machine and are not required to be capitalized under paragraph (d)(1) of this section. However, because the amounts paid for the scheduled maintenance are incurred by reason of X's manufacturing operations, X is required to capitalize the amounts paid for the maintenance to products produced by X. See § 1.263A-1(e)(3)(ii).

Example 5.

Routine maintenance; replacement of substantial structural part. X is in the business of producing commercial products for sale. As part of the production process, X places raw materials into lined containers in which a chemical reaction is used to convert raw materials into the finished product. The lining is a substantial structural part of the container, and comprises 60% of the total physical structure of the container. Assume that each container, including its lining, is the unit of property and that a container has a class life of 12 years. At the time that X placed the container into service, X was aware that approximately every three years, X would be required to replace the lining in the container with comparable and commercially available and reasonable replacement materials. At the end of that period, the container will continue to function, but will become less efficient and the replacement of the lining will be necessary to keep the container in an ordinarily efficient operating condition. In 2003, X acquired 10 new containers and placed them into service. In 2006, 2009, 2011, and 2014, X pays amounts to replace the containers' linings with comparable and commercially available and reasonable replacement parts. Assume that none of the exceptions set out in paragraph (e)(2) of this section apply to the amounts paid for the replacement linings. Because the replacement of the linings involves recurring activities that X expects to perform as a result of its use of the containers to keep the containers in their ordinarily efficient operating condition, and consists of maintenance activities that X expects to perform more than once during the 12 year class lives of the containers, X's lining replacement costs are within the routine maintenance safe harbor under paragraph (e) of this section. Accordingly, the amounts paid by X for the replacement of the container linings are deemed not to improve the containers and are not required to be capitalized under paragraph (d)(1) of this section. However, because the amounts paid to replace the container linings are incurred by reason of X's manufacturing operations, X is required to capitalize the amounts paid for the replacements to products produced by X. See § 1.263A-1(e)(3)(ii).

Example 6.

Routine maintenance once during class life. X is a Class I railroad that owns a fleet of freight cars. Assume that a freight car, including all its components, is a unit of property and has a class life of 14 years. At the time that X places a freight car into service, X expects to perform cyclical reconditioning to the car every 8 to 10 years in order to keep the freight car in ordinarily efficient operating condition. During this reconditioning, X incurs costs to disassemble, inspect, and recondition and/or replace components of the freight car with comparable and commercially available and reasonable replacement parts. Ten years after the freight car is placed in service by X, X incurs costs to perform a cyclical reconditioning on the car. Because X expects to perform the reconditioning only once during the 14 year class life of the freight car, the costs incurred for reconditioning do not qualify for the routine maintenance safe harbor under paragraph (e) of this section. Accordingly, X must capitalize the amounts paid for the reconditioning of the freight car if these amounts result in an improvement under paragraph (d)(1) of this section.

Example 7.

Routine maintenance on non-rotable part. X is a towboat operator that owns and leases a fleet of towboats. Each towboat is equipped with two diesel-powered engines. Assume that each towboat, including its engines, is the unit of property and that a towboat has a class life of 18 years. At the time that X places its towboats into service, X is aware that approximately every three to four years, X will need to perform scheduled maintenance on the two towboat engines to keep the engines in their ordinarily efficient operating condition. This maintenance is completed while the engines are attached to the towboat and involves the cleaning and inspecting of the engines to determine which parts are within acceptable operating tolerances and can continue to be used, which parts must be reconditioned to be brought back to acceptable tolerances, and which parts must be replaced. Engine parts replaced during these procedures are replaced with comparable and commercially available and reasonable replacement parts. Assume the towboat engines are not rotable spare parts under § 1.162-3(b). In 2005, X acquired a new towboat, including its two engines, and placed the towboat into service. In 2009, X incurs amounts to perform scheduled maintenance on both engines in the towboat. Assume that none of the exceptions set out in paragraph (e)(2) of this section apply to the scheduled maintenance costs. Because the scheduled maintenance involves recurring activities that X expects to perform more than once during the 18 year class life of the towboat. This maintenance results from X's use of the towboat, and is performed to keep the towboat in an ordinarily efficient operating condition, the scheduled maintenance on X's towboat is within the routine maintenance safe harbor under paragraph (e) of this section. Accordingly, the amounts paid by X for the scheduled maintenance to its towboat engines in 2009 are deemed not to improve the towboat and are not required to be capitalized under paragraph (d)(1) of this section.

Example 8.

Routine maintenance with betterments. Assume the same facts as Example 7, except that in 2013, X's towboat engines are due for another scheduled maintenance visit. At this time X decides to upgrade the engines to increase their horsepower and propulsion, which would permit the towboats to tow heavier loads. Accordingly, in 2013 X incurs costs to perform many of the same activities that it would perform during the typical scheduled maintenance activities such as cleaning, inspecting, reconditioning, and replacing minor parts, but at the same time, X incurs costs to upgrade certain engine parts to increase the towing capacity of the boats in excess of the capacity when the boats were placed in service by X. Both the scheduled maintenance procedures and the replacement of parts with new and upgraded parts are necessary to increase the horsepower of the engines and the towing capacity of the boat. Thus, the work done on the engines encompasses more than the recurring activities that X expected to perform as a result of its use of the towboats and did more than keep the towboat in its ordinarily efficient operating condition. In addition, the scheduled maintenance procedures directly benefit and are incurred by reason of the upgrades. Therefore, the amounts paid by X in 2013 for the maintenance and upgrade of the engines do not qualify for the routine maintenance safe harbor described under paragraph (e) of this section. These amounts must be capitalized if they result in a betterment under paragraph (f) of this section, including a material increase in the capacity of the towboat, or otherwise result in an improvement under paragraph (d)(1) of this section. See also section 263A requiring taxpayers to capitalize all the direct costs of an improvement to property and all the indirect costs that directly benefit or are incurred by reason of an improvement to property.

Example 9.

Exceptions to routine maintenance. X owns and operates a farming and cattle ranch with an irrigation system that provides water for crops. Assume that each canal in the irrigation system is a single unit of property and has a class life of 20 years. When X placed the canals into service, X expected to have to perform major maintenance on the canals every 3 years to keep the canals in their ordinarily efficient operating condition. This maintenance included draining the canals, and then cleaning, inspecting, repairing, reconditioning or replacing parts of the canal with comparable and commercially available and reasonable replacement parts. X placed the canals into service in 2005 and did not perform any maintenance on the canals until 2010. At that time, the canals had fallen into a state of disrepair and no longer functioned for irrigation. In 2010, X paid amounts to drain the canals, and do extensive cleaning, repairing, reconditioning and replacing parts of the canals with comparable and commercially available and reasonable replacement parts. Although the work performed on X's canals was similar to the activities that X expected to perform, but did not perform, every three years, the costs of these activities do not fall within the routine maintenance safe harbor. Specifically, under paragraph (e)(2)(iv) of this section, routine maintenance does not include amounts paid to return a unit of property to its former ordinary efficient operating condition if the property has deteriorated to a state of disrepair and is no longer functional for its intended use. Accordingly, amounts paid by X for work performed on the canals in 2010 must be capitalized if they result in improvements under paragraph (d)(1) of this section (for example, restorations under paragraph (g) of this section).