

(f) For rules with respect to the reporting and substantiation of traveling and other business expenses of employees for taxable years beginning after December 31, 1957, see § 1.162-17.

§ 1.162-3 Materials and supplies.

(a) through (k) [Reserved] For further guidance, see § 1.163-3T(a) through (k).

[T.D. 9564, 77 FR 18687, Mar. 28, 2012]

§ 1.162-3T Materials and supplies (temporary).

(a) *In general*—(1) *Non-incident materials and supplies.* Amounts paid to acquire or produce materials and supplies are deductible in the taxable year in which the materials and supplies are used or consumed in the taxpayer's operations.

(2) *Incidental materials and supplies.* Amounts paid to acquire or produce incidental materials and supplies that are carried on hand and for which no record of consumption is kept or of which physical inventories at the beginning and end of the taxable year are not taken, are deductible in the taxable year in which these amounts are paid, provided taxable income is clearly reflected.

(3) *Use or consumption of rotatable and temporary spare parts.* Except as provided in paragraphs (d), (e), and (f) of this section, for purposes of paragraph (a)(1) of this section, rotatable and temporary spare parts (defined under paragraph (c)(2) of this section) are used or consumed in the taxpayer's operations in the taxable year in which the taxpayer disposes of the parts.

(b) *Coordination with other provisions of the Internal Revenue Code.* 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 other than section 162(a) or section 212 and the regulations under those sections. For example, see section § 1.263(a)-3T, which requires taxpayers to capitalize amounts paid to improve tangible property and section 263A and the regulations under section 263A, which require taxpayers to capitalize the direct and allocable indirect costs, including the cost of materials and supplies, to property produced or to

property acquired for resale. See also § 1.471-1, which requires taxpayers to include in inventory certain materials and supplies.

(c) *Definitions*—(1) *Materials and supplies.* For purposes of this section, *materials and supplies* means tangible property that is used or consumed in the taxpayer's operations that is not inventory and that—

(i) Is a component acquired to maintain, repair, or improve a unit of tangible property (as determined under § 1.263(a)-3T(e)) owned, leased, or serviced by the taxpayer and that is not acquired as part of any single unit of tangible property;

(ii) Consists of fuel, lubricants, water, and similar items, that are reasonably expected to be consumed in 12 months or less, beginning when used in taxpayer's operations;

(iii) Is a unit of property as determined under § 1.263(a)-3T(e) that has an economic useful life of 12 months or less, beginning when the property is used or consumed in the taxpayer's operations;

(iv) Is a unit of property as determined under § 1.263(a)-3T(e) that has an acquisition cost or production cost (as determined under section 263A) of \$100 or less (or other amount as identified in published guidance in the FEDERAL REGISTER or in the Internal Revenue Bulletin (see § 601.601(d)(2)(ii)(b) of this chapter)); or

(v) Is identified in published guidance in the FEDERAL REGISTER or in the Internal Revenue Bulletin (see § 601.601(d)(2)(ii)(b) of this chapter) as materials and supplies for which treatment is permitted under this section.

(2) *Rotatable and temporary spare parts.* For purposes of this section, rotatable spare parts are materials and supplies under paragraph (c)(1)(i) of this section that are acquired for installation on a unit of property, removable from that unit of property, generally repaired or improved, and either reinstalled on the same or other property or stored for later installation. Temporary spare parts are materials and supplies under paragraph (c)(1)(i) of this section that are used temporarily until a new or repaired part can be installed and then are removed and stored for later (emergency or temporary) installation.

(3) *Economic useful life*—(i) *General rule.* The economic useful life of a unit of property is not necessarily the useful life inherent in the property but is the period over which the property may reasonably be expected to be useful to the taxpayer or, if the taxpayer is engaged in a trade or business or an activity for the production of income, the period over which the property may reasonably be expected to be useful to the taxpayer in its trade or business or for the production of income, as applicable. See §1.167(a)-1(b) for the factors to be considered in determining this period.

(ii) *Taxpayers with an applicable financial statement.* For taxpayers with an applicable financial statement (as defined in paragraph (c)(3)(iii) of this section), the economic useful life of a unit of property, solely for the purposes of applying the provisions of paragraph (c)(1)(iii) of this section, is the useful life initially used by the taxpayer for purposes of determining depreciation in its applicable financial statement, regardless of any salvage value of the property. If a taxpayer does not have an applicable financial statement for the taxable year in which a unit of property was originally acquired or produced, the economic useful life of the unit of property must be determined under paragraph (c)(3)(i) of this section. Further, if a taxpayer treats amounts paid for a unit of property as an expense in its applicable financial statement on a basis other than the useful life of the property or if a taxpayer does not depreciate the unit of property on its applicable financial statement, the economic useful life of the unit of property must be determined under paragraph (c)(3)(i) of this section. For example, if a taxpayer has a policy of treating as an expense on its applicable financial statement amounts paid for a unit of property costing less than a certain dollar amount, notwithstanding that the unit of property has a useful life of more than one year, the economic useful life of the unit of property must be determined under paragraph (c)(3)(i) of this section.

(iii) *Definition of applicable financial statement.* The taxpayer's applicable financial statement is the taxpayer's fi-

ancial statement listed in paragraphs (c)(3)(iii)(A) through (C) of this section that has the highest priority (including within paragraph (c)(3)(iii)(B) of this section). The financial statements are, in descending priority—

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

(B) 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—

(1) Credit purposes;

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

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

(C) 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).

(4) *Amount paid.* For purposes of this section, 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.

(5) *Produce.* For purposes of this section, *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 (c)(5) and are separately defined and addressed in §1.263(a)-3T. Amounts paid to produce materials and supplies are subject to section 263A.

(d) *Election to capitalize and depreciate*—(1) *In general.* A taxpayer may elect to treat as a capital expenditure and to treat as an asset subject to the allowance for depreciation the cost of any material or supply as defined in paragraph (c)(1) of this section. Except as specified in paragraph (d)(2) of this section, an election made under this

paragraph (d) applies to amounts paid during the taxable year to acquire or produce any material or supply to which paragraph (a) of this section would apply (but for the election under this paragraph (d)). Any asset for which this election is made shall not be treated as a material or a supply.

(2) *Exceptions.* A taxpayer may not elect to capitalize and depreciate under paragraph (d) of this section—

(i) Any amount paid to acquire or produce a material or supply described in paragraph (c)(1)(i) of this section if—

(A) The material or supply is intended to be used as a component of a unit of property that is a material or supply under paragraph (c)(1)(iii), (iv), or (v) of this section; and

(B) The taxpayer has not elected to capitalize and depreciate that unit of property under this paragraph (d); or

(ii) Any amount paid to acquire or produce a rotatable or temporary spare part if the taxpayer has applied the optional method of accounting for rotatable and temporary spare parts under paragraph (e) of this section.

(3) *Manner of electing.* A taxpayer makes the election under paragraph (d) of this section by capitalizing the amounts paid to acquire or produce a material or supply in the taxable year the amounts are paid and by beginning to recover the costs when the asset is placed in service by the taxpayer for the purposes of determining depreciation under the applicable provisions of Internal Revenue Code and regulations thereunder. A taxpayer must make this election in its timely filed original Federal income tax return (including extensions) for the taxable year the asset is placed in service by the taxpayer for purposes of determining depreciation. See § 1.263(a)-2T for the treatment of amounts paid to acquire or produce real or personal tangible property. In the case of a pass-through entity, the election is made by the pass-through entity, and not by the shareholders or partners. A taxpayer may make an election for each material or supply that qualifies for the election under this paragraph (d). A taxpayer may revoke an election made under this paragraph (d) with respect to a material or supply 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.

(e) *Optional method of accounting for rotatable and temporary spare parts—(1) In general.* This paragraph (e) provides an optional method of accounting for rotatable and temporary spare parts (the optional method for rotatables). A taxpayer may use the optional method for rotatables, instead of the general rule under paragraph (a)(3) of this section, to account for its rotatable and temporary spare parts as defined in paragraph (c)(2) of this section. A taxpayer that uses the optional method for rotatables must use this method for all of its rotatable and temporary spare parts in the same trade or business. The optional method for rotatables is a method of accounting under section 446(a). Under the optional method for rotatables, the taxpayer must apply the rules in this paragraph (e) to each rotatable or temporary spare part (part) upon the taxpayer's initial installation, removal, repair, maintenance or improvement, reinstallation, and disposal of each part.

(2) *Description of optional method for rotatables—(i) Initial installation.* The taxpayer must deduct the amount paid to acquire or produce the part in the taxable year that the part is first installed on a unit of property for use in the taxpayer's operations.

(ii) *Removal from unit of property.* In each taxable year in which the part is removed from a unit of property to which it was initially or subsequently installed, the taxpayer must—

(A) Include in gross income the fair market value of the part; and

(B) Include in the basis of the part the fair market value of the part included in income under paragraph (e)(2)(ii)(A) of this section and the amount paid to remove the part from the unit of property.

(iii) *Repair, maintenance, or improvement of part.* The taxpayer may not currently deduct and must include in the basis of the part any amounts paid to maintain, repair, or improve the part in the taxable year these amounts are paid.

(iv) *Reinstallation of part.* The taxpayer must deduct the amounts paid to reinstall the part and those amounts included in the basis of the part under paragraphs (e)(2)(ii)(B) and (e)(2)(iii) of this section, to the extent that those amounts have not been previously deducted under this paragraph (e)(2)(iv), in the taxable year that the part is reinstalled on a unit of property.

(v) *Disposal of the part.* The taxpayer must deduct the amounts included in the basis of the part under paragraphs (e)(2)(ii)(B) and (e)(2)(iii) of this section, to the extent that those amounts have not been previously deducted under paragraph (e)(2)(iv) of this section, in the taxable year in which the part is disposed of by the taxpayer.

(f) *Election to apply de minimis rule—*

(1) *In general.* A taxpayer may elect to apply the de minimis rule under § 1.263(a)-2T(g) to any material or supply defined in paragraph (c)(1) this section. Any material or supply to which the taxpayer elects to apply the de minimis rule under § 1.263(a)-2T(g) is not treated as a material or supply under this section. See § 1.263(a)-2T(g)(5).

(2) *Manner of electing.* A taxpayer makes the election by deducting the amounts paid to acquire or produce a material or supply in the taxable year that the amounts are paid and by complying with the requirements set out in § 1.263(a)-2T(g). A taxpayer must make this election in its timely filed original Federal income tax return (including extensions) for the taxable year that amounts are paid for the material or supply. In the case of a pass-through entity, the election is made by the pass-through entity and not by the shareholders or partners. A taxpayer may make an election for each material or supply that qualifies for the election under paragraph (f) of this section. A taxpayer may revoke an election made under paragraph (f) of this section with respect to a material or supply 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.

(g) *Sale or disposition of materials and supplies.* Upon sale or other disposition, materials and supplies as defined in this section are not treated as a capital asset under section 1221 or as property used in the trade or business under section 1231. Any asset for which the taxpayer makes the election to capitalize and depreciate under paragraph (d) of this section shall not be treated as a material or supply.

(h) *Examples.* The rules of this section are illustrated by the following examples, in which it is assumed (unless otherwise stated) that the property is not an incidental material or supply, that the taxpayer is a calendar year, accrual method taxpayer, and that the taxpayer has not elected to capitalize under paragraph (d) of this section or to apply the de minimis rule under paragraph (f) of this section.

Example 1. Non-rotatable components. X owns a fleet of aircraft that it operates in its business. In Year 1, X purchases a stock of spare parts, which it uses to maintain and repair its aircraft. X keeps a record of consumption of these spare parts. In Year 2, X uses the spare parts for the repair and maintenance of one of its aircraft. Assume each aircraft is a unit of property under § 1.263(a)-3T(e) and that spare parts are not rotatable or temporary spare parts under paragraph (c)(2) of this section. Assume these repair and maintenance activities do not improve the aircraft under § 1.263(a)-3T. These parts are materials and supplies under paragraph (c)(1)(i) of this section because they are components acquired and used to maintain and repair X's aircraft. Under paragraph (a)(1) of this section, the amounts that X paid for the spare parts in Year 1 are deductible in Year 2, the taxable year in which the spare parts are used to repair and maintain the aircraft.

Example 2. Rotatable spare parts. X operates a fleet of specialized vehicles that it uses in its service business. Assume that each vehicle is a unit of property under § 1.263(a)-3T(e). At

the time that it acquires a new type of vehicle, X also acquires a substantial number of rotatable spare parts that it will keep on hand to quickly replace similar parts in X's vehicles as those parts break down or wear out. These rotatable parts are removable from the vehicles and are repaired so that they can be reinstalled on the same or similar vehicles. X does not use the optional method of accounting for rotatable and temporary spare parts provided in paragraph (e) of this section. In Year 1, X acquires several vehicles and a number of rotatable spare parts to be used as replacement parts in these vehicles. In Year 2, X repairs several vehicles by using these rotatable spare parts to replace worn or damaged parts. In Year 3, X removes these rotatable spare parts from its vehicles, repairs the parts, and reinstalls them on other similar vehicles. In Year 5, X can no longer use the rotatable parts it acquired in Year 1 and disposes of them as scrap. Under paragraph (c)(1)(i) of this section, the rotatable spare parts acquired in Year 1 are materials and supplies. Under paragraph (a)(3) of this section, rotatable spare parts are generally used or consumed in the taxable year in which the taxpayer disposes of the parts. Therefore, under paragraph (a)(1) of this section, the amounts that X paid for the rotatable spare parts in Year 1 are deductible in Year 5, the taxable year in which X disposes of the parts.

Example 3. Rotatable spare parts; application of optional method of accounting. Assume the same facts as in *Example 2*, except X uses the optional method of accounting for all its rotatable and temporary spare parts under paragraph (e) of this section. In Year 1, X acquires several vehicles and a number of rotatable spare parts (the "Year 1 rotatables") to be used as replacement parts in these vehicles. In Year 2, X repairs several vehicles and uses the Year 1 rotatables to replace worn or damaged parts. In Year 3, X pays amounts to remove these Year 1 rotatables from its vehicles. In Year 4, X pays amounts to maintain, repair, or improve the Year 1 rotatables. In Year 5, X pays amounts to reinstall the Year 1 rotatables on other similar vehicles. In Year 8, X removes the Year 1 rotatables from these vehicles and stores these parts for possible later use. In Year 9, X disposes of the Year 1 rotatables. Under paragraph (e) of this section, X must deduct the amounts paid to acquire and install the Year 1 rotatables in Year 2, the taxable year in which the rotatable spare parts are first installed by X in X's vehicles. In Year 3, when X removes the Year 1 rotatables from its vehicles, X must include in its gross income the fair market value of each part. Also, in Year 3, X must include in the basis of each Year 1 rotatable the fair market value of the rotatable and the amount paid to remove the rotatable from the vehicle. In Year 4, X must include in the basis of each Year 1 rotatable the amounts paid to maintain, re-

pair, or improve each rotatable. In Year 5, the year that X reinstalls the Year 1 rotatables (as repaired or improved) in other vehicles, X must deduct the reinstallation costs and the amounts previously included in the basis of each part. In Year 8, the year that X removes the Year 1 rotatables from the vehicles, X must include in income the fair market value of each rotatable part removed. In addition, in Year 8, X must include in the basis of each part the fair market value of that part and the amount paid to remove the each rotatable from the vehicle. In Year 9, the year that X disposes of the Year 1 rotatables, X may deduct the amounts remaining in the basis of each rotatable.

Example 4. Rotatable part acquired as part of a single unit of property; not material or supply. X operates a fleet of aircraft. In Year 1, X acquires a new aircraft, which includes two new aircraft engines. The aircraft costs \$500,000 and has an economic useful life of more than 12 months, beginning when it is placed in service. In Year 5, after the aircraft is operated for several years in X's business, X removes the engines from the aircraft, repairs or improves the engines, and either reinstalls the engines on a similar aircraft or stores the engines for later reinstallation. Assume the aircraft purchased in Year 1, including its two engines, is a unit of property under §1.263(a)-3T(e). Because the engines were acquired as part of the aircraft, a single unit of property, the engines are not materials or supplies under paragraph (c)(1)(i) of this section nor rotatable or temporary spare parts under paragraph (c)(2) of this section. Accordingly, X may not apply the rules of this section to the aircraft engines upon the original acquisition of the aircraft nor after the removal of the engines from the aircraft for use in the same or similar aircraft. Rather, X must apply the rules under §§1.263(a)-2T and 1.263(a)-3T to the aircraft, including its engines, to determine the treatment of amounts paid to acquire, produce, or improve the unit of property.

Example 5. Components of real property. X owns an apartment building that it leases in its business operation and discovers that a window in one of the apartments is broken. Assume that the building, including its windows, is a unit of property under §1.263(a)-3T(e) and the window is not a rotatable or temporary spare part under paragraph (c)(2) of this section. X pays for the acquisition and delivery of a new window to replace the broken window. In the same taxable year, the new window is installed. Assume that the replacement of the window does not improve the property under §1.263(a)-3T and that X does not recognize gain or loss on the disposition of the broken window. The new window is a material or supply under paragraph (c)(1)(i) of this section because it is a component acquired and used to repair a unit of

property owned by X and used in X's operations. Under paragraph (a)(1) of this section, the amounts X paid for the acquisition and delivery of the window are deductible in the taxable year in which the window is installed in the apartment building. See § 1.168(i)-8T for the treatment of the disposition of the broken window.

Example 6. Consumable property. X operates a fleet of aircraft that carries freight for its customers. X has several storage tanks on its premises, which hold jet fuel for its aircraft. Assume that once the jet fuel is placed in X's aircraft, the jet fuel is reasonably expected to be consumed within 12 months or less. On December 31, Year 1, X purchases a two-year supply of jet fuel. In Year 2, X uses a portion of the jet fuel purchased on December 31, Year 1, to fuel the aircraft used in its business. The jet fuel that X purchased in Year 1 is a material or supply under paragraph (c)(1)(ii) of this section because it is reasonably expected to be consumed within 12 months or less from the time it is placed in X's aircraft. Under paragraph (a)(1) of this section, X may deduct in Year 2 the amounts paid for the portion of jet fuel used in the operation of X's aircraft in Year 2.

Example 7. Unit of property that costs \$100 or less. X operates a business that rents out a variety of small individual items to customers (rental items). X maintains a supply of rental items on hand. In Year 1, X purchases a large quantity of rental items to use in its rental business. Assume that each rental item is a unit of property under § 1.263(a)-3T(e) and costs \$100 or less. In Year 2, X begins using all the rental items purchased in Year 1 by providing them to customers of its rental business. X does not sell or exchange these items on established retail markets at any time after the items are used in the rental business. The rental items are materials and supplies under paragraph (c)(1)(iv) of this section. Under paragraph (a)(1) of this section, the amounts that X paid for the rental items in Year 1 are deductible in Year 2, the taxable year in which the rental items are used in X's business.

Example 8. Unit of property that costs \$100 or less. X provides billing services to its customers. In Year 1, X pays amounts to purchase 50 facsimile machines to be used by its employees. Assume each facsimile machine is a unit of property under § 1.263(a)-3T(e) and costs less than \$100. In Year 1, X's employees begin using 35 of the facsimile machines, and X stores the remaining 15 machines for use in a later taxable year. The facsimile machines are materials and supplies under paragraph (c)(1)(iv) of this section. Under paragraph (a)(1) of this section, the amounts X paid for 35 of the facsimile machines are deductible in Year 1, the taxable year in which X uses those machines. The amounts that X paid for each of the re-

maining 15 machines are deductible in the taxable year in which each machine is used.

Example 9. Materials and supplies used in improvements; coordination with § 1.263(a)-3T. X owns various machines that are used in its business. Assume that each machine is a unit of property under § 1.263(a)-3T(e). In Year 1, X purchases a supply of spare parts for its machines. X acquired the parts to use in the repair or maintenance of the machines under § 1.162-4T or in the improvement of the machines under § 1.263(a)-3T. The spare parts are not rotatable or temporary spare parts under paragraph (c)(2) of this section. In Year 2, X uses all of these spare parts in an activity that improves a machine under § 1.263(a)-3T. Under paragraph (c)(1)(i) of this section, the spare parts purchased by X in Year 1 are materials and supplies. Under paragraph (a)(1) of this section, the amounts paid for the spare parts are otherwise deductible as materials and supplies in Year 2, the taxable year in which X uses those parts. However, because these materials and supplies are used to improve X's machine, X is required to capitalize the amounts paid for those spare parts under § 1.263(a)-3T. See also section 263A for the requirement to capitalize the direct and allocable indirect costs of property produced or property acquired for resale.

Example 10. Cost of producing materials and supplies; coordination with section 263A. X is a manufacturer that produces liquid waste as part of its operations. X determines that its current liquid waste disposal process is inadequate. To remedy the problem, in Year 1, X constructs a leaching pit to provide a draining area for the liquid waste. Assume the leaching pit is a unit of property under § 1.263(a)-3T(e) and has an economic useful life 12 months or less, starting on the date that X begins to use the leaching pit as a draining area. At the end of this period, X's factory will be connected to the local sewer system. In Year 2, X starts using the leaching pit in its operations. The amounts paid to construct the leaching pit (including the direct and allocable indirect costs of property produced under section 263A) are amounts paid for a material or supply under paragraph (c)(1)(iii) of this section. Under paragraph (a)(1) of this section, the amounts paid for the leaching pit are otherwise deductible as materials and supplies in Year 2, the taxable year in which X uses the leaching pit. However, because the amounts paid to construct the leaching pit directly benefit or are incurred by reason of X's manufacturing operations, X must capitalize those costs under section 263A to the property produced. See § 1.263A-1(e)(3)(ii)(E).

Example 11. Costs of acquiring materials and supplies for production of property; coordination with section 263A. In Year 1, X purchases jigs, dies, molds, and patterns for use in the manufacture of X's products. Assume each

jig, die, mold, and pattern is a unit of property under § 1.263(a)-3T(e). The economic useful life of each jig, die, mold, and pattern is 12 months or less, beginning when each item is used in the manufacturing process. The jigs, dies, molds, and patterns are not components acquired to maintain, repair, or improve any of X's equipment under paragraph (c)(1)(i) of this section. X begins using the jigs, dies, molds and patterns in Year 2 to manufacture its products. These items are materials and supplies under paragraph (c)(1)(iii) of this section. Under paragraph (a)(1) of this section, the amounts paid for the items are otherwise deductible in Year 2, the taxable year in which X uses those items. However, because the amounts paid for these materials and supplies directly benefit or are incurred by reason of X's manufacturing operations, X must capitalize the costs under section 263A to the property produced. See § 1.263A-1(e)(3)(i)(E).

Example 12. Election to capitalize and depreciate. X operates a rental business that rents out a variety of items (rental items) to its customers. Assume each rental item is a separate unit of property as determined under § 1.263(a)-3T(e). X does not sell or exchange these items on established retail markets at any time after the items are used in the rental business. X purchases various rental items, each of which costs less than \$100 or has an economic useful life of 12 months or less, beginning when the items are used or consumed. The rental items are materials and supplies under paragraph (c)(1)(iii) or (c)(1)(iv) of this section. Under paragraph (a)(1) of this section, the amount paid for each rental item is deductible in the taxable year in which the item is used in the rental business. However, X would prefer to treat the cost of each rental item as a capital expenditure subject to depreciation. Under paragraph (d) of this section, X may elect not to apply the rule contained in paragraph (a)(1) of this section to the rental items. X makes this election by capitalizing the amounts paid for each rental item in the taxable year that X purchases the item and by beginning to recover the costs of each item on its timely filed Federal income tax return for the taxable year that X places the item in service for purposes of determining depreciation under the applicable provisions of the Internal Revenue Code and the regulations thereunder. See § 1.263(a)-2T(h) for the treatment of capital expenditures.

Example 13. Election to capitalize and depreciate. X is an electric utility. X acquires certain temporary spare parts, which it keeps on hand to avoid operational time loss in the event it must make emergency repairs to a unit of property that is subject to depreciation. These parts are not used to improve property under § 1.263(a)-3T(d). These temporary spare parts are used until a new or repaired part can be installed and then are re-

moved and stored for later emergency installation. X does not use the optional method of accounting for rotatable and temporary spare parts in paragraph (e) of this section for any of its rotatable or temporary spare parts. The temporary spare parts are materials and supplies under paragraph (c)(1)(i) of this section. Under paragraphs (a)(1) and (a)(3) of this section, the amounts paid for the temporary spare parts are deductible in the taxable year in which they are disposed of by the taxpayer. However, because it is unlikely that the temporary spare parts will be disposed of in the near future, X would prefer to treat the amounts paid for the spare parts as capital expenditures subject to depreciation. X may elect under paragraph (d) of this section not to apply the rule contained in paragraph (a)(1) of this section to each of its temporary spare parts. X makes this election by capitalizing the amounts paid for each spare part in the taxable year that X acquires the spare parts and by beginning to recover the costs of each part on its timely filed Federal income tax return for the taxable year in which the part is placed in service for purposes of determining depreciation under the applicable provisions of the Internal Revenue Code and the regulations thereunder. See § 1.263(a)-2T(h) for the treatment of capital expenditures and section 263A for the requirement to capitalize the direct and allocable indirect costs of property produced or property acquired for resale.

Example 14. Election to apply de minimis rule. X provides consulting services to its customers. X purchases 50 office chairs to be used by its employees. Each office chair is a unit of property that costs \$80. Also in the same taxable year, X pays amounts to purchase 50 customized briefcases. Assume each briefcase is a unit of property under § 1.263(a)-3T(e), costs \$120, and has an economic useful life of 12 months or less, beginning when used and consumed. X has an applicable financial statement (as defined in § 1.263(a)-2T(g)(6)), and X has a written policy at the beginning of the taxable year to expense amounts paid for units of property costing less than \$300. The briefcases and the office chairs are materials and supplies under paragraph (c)(1)(iii) and (c)(1)(iv), respectively, of this section. Under paragraph (a)(1) of this section, the amounts paid for the office chairs and briefcases are deductible in the taxable year in which they are used or consumed. However, assuming X meets all the requirements of § 1.263(a)-2T(g), X may elect under paragraph (f) of this section to apply the de minimis rule under § 1.263(a)-2T(g) to amounts paid for the office chairs and briefcases, rather than treat these amounts as the costs of materials and supplies under § 1.162-3T.

(i) *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.

(j) *Effective/applicability date.* This section generally applies to amounts paid or incurred (to acquire or produce property) in taxable years beginning on or after January 1, 2012. However, a taxpayer may apply § 1.162-3T(e) (the optional method of accounting for rotatable and temporary spare parts) to taxable years beginning on or after January 1, 2012. For the applicability of regulations to taxable years beginning before January 1, 2012, see § 1.162-3 in effect prior to January 1, 2012 (§ 1.162-3 as contained in 26 CFR part 1 edition revised as of April 1, 2011).

(k) *Expiration date.* The applicability of this section expires on December 23, 2014.

[T.D. 9564, 76 FR 81080, Dec. 27 2011; 77 FR 18687, Mar. 28, 2012]

§ 1.162-4 Repairs.

(a) through (d) [Reserved] For further guidance, see § 1.162-4T(a) through (d).

[T.D. 9564, 76 FR 81084, Dec. 27, 2011]

§ 1.162-4T Repairs (temporary).

(a) *In general.* A taxpayer may deduct amounts paid for repairs and maintenance to tangible property if the amounts paid are not otherwise required to be capitalized.

(b) *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 Commis-

sioner's consent to change its accounting method.

(c) *Effective/applicability date.* This section applies to taxable years beginning on or after January 1, 2012. For the applicability of regulations to taxable years beginning before January 1, 2012, see § 1.162-4 in effect prior to January 1, 2012 (§ 1.162-4 as contained in 26 CFR part 1 edition revised as of April 1, 2011).

(d) *Expiration date.* The applicability of this section expires on December 23, 2014

[T.D. 9564, 76 FR 81084, Dec. 27, 2011]

§ 1.162-5 Expenses for education.

(a) *General rule.* Expenditures made by an individual for education (including research undertaken as part of his educational program) which are not expenditures of a type described in paragraph (b) (2) or (3) of this section are deductible as ordinary and necessary business expenses (even though the education may lead to a degree) if the education—

(1) Maintains or improves skills required by the individual in his employment or other trade or business, or

(2) Meets the express requirements of the individual's employer, or the requirements of applicable law or regulations, imposed as a condition to the retention by the individual of an established employment relationship, status, or rate of compensation.

(b) *Non deductible educational expenditures—*(1) *In general.* Educational expenditures described in subparagraphs (2) and (3) of this paragraph are personal expenditures or constitute an inseparable aggregate of personal and capital expenditures and, therefore, are not deductible as ordinary and necessary business expenses even though the education may maintain or improve skills required by the individual in his employment or other trade or business or may meet the express requirements of the individual's employer or of applicable law or regulations.

(2) *Minimum educational requirements.*

(i) The first category of non deductible educational expenses within the scope of subparagraph (1) of this paragraph are expenditures made by an individual for education which is required of him