



# New IRS Regulations Modify Interest Capitalization Requirements for Property Improvements

## Client Advisories

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## Background

On October 2, 2025, the IRS and Treasury Department issued final regulations ([TD 10034](#)) (the “**Final Rules**”) simplifying the interest capitalization rules for improvements that constitute the production of designated property under §263A(f) of the Internal Revenue Code. The Final Rules eliminate the “associated property rule,” which previously required capitalization of interest on property temporarily withdrawn from service or not yet placed in service, and make conforming amendments for consistency. These changes were issued in response to the Federal Circuit’s decision in *Dominion Resources, Inc. v. United States*, [681 F.3d 1313 \(Fed. Cir. 2012\)](#), which invalidated portions of the associated property rule as inconsistent with the avoided cost principle underlying §263A(f). Effective October 2, 2025, the Final Rules apply to tax years beginning thereafter.

## Summary of Key Changes and Impact

- **Removing the Associated Property Rule.** The Final Rules remove the “associated property rule” and related provisions previously found in Treas. Reg. §1.263A-11(e) from the interest capitalization requirements for improvements that constitute the production of designated property under §263A(f) and §1.263A-8(d)(3). Following this change, accumulated production expenditures (APEs) for improvements will include only the direct and indirect costs of the improvement itself. Under the prior regulations, when a taxpayer made an improvement to real property (or to tangible property), the APEs to which interest had to be capitalized also included an allocable portion of the cost of land (in some scenarios) and the adjusted basis of any existing structure, common feature or other property that was not placed in service or had to be temporarily withdrawn from service. Practically, this change should reduce the amount of interest that must be capitalized.

- **Amending “Improvement” Definition.** The Final Rules amend the definition of “improvement” in § 1.263A-8(d)(3) to align with the definition in § 1.263(a)-3, including its exceptions, safe harbors, and elective provisions. This amendment clarifies the scope of improvements that constitute the “production of property” and creates greater consistency between tangible property rules and UNICAP (interest capitalization) rules.
- **Clarifying the Mid-Production Purchase Rule.** The Final Rules clarify that the mid-production purchases rule in § 1.263A-11(f) should apply only when “a taxpayer purchases a unit of property for further production before the purchased unit of property is placed in service.” In such cases, the taxpayer’s APEs include the full purchase price of the property, and any additional direct and indirect production costs capitalized during the production period. This preserves the capitalization of costs for units purchased mid-production, but under a much clearer boundary.

### Who Will Be Impacted

The changes apply to improvements to real property or tangible personal property that are “designated property” under Section 263A, or, more specifically, those subject to interest capitalization. They will primarily affect large and mid-sized taxpayers with average annual gross receipts exceeding \$25 million (adjusted for inflation) that are engaged in the improvement or construction of real or tangible personal property that is or becomes “designated property” under the Code; smaller taxpayers remain exempt. While the changes impose no new recordkeeping or reporting burdens, adopting the new rules may require a change in accounting method under Sections 446 and 481, although it is not clear how many taxpayers will be affected at this time.

If you have questions about how this legislation may affect you or your organization, please reach out to tax partner **Bonnie Diaz** at [bdiaz@archerlaw.com](mailto:bdiaz@archerlaw.com) or Zhao Li at [zli@archerlaw.com](mailto:zli@archerlaw.com).

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### Related People



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