Retroactive tax benefits for real estate owners! Part 1

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The 2012 Taxpayer Relief Act (2012 TRA), which will be signed by the President in short order, has reinstated and extended several key tax breaks for real estate owners. These breaks include both retroactive (2012) and prospective (2013) changes related to bonus depreciation, Code Section 179, qualified leasehold improvements, qualified restaurant improvements, and qualified retail property. Using cost segregation to justify allowable deductions for these retroactive changes or the new repairs and maintenance regulations provides tax practitioners ample fire-power to significantly reduce their real estate clients tax exposure.

First-Year Bonus Depreciation for 2013: Prior to the new law, 50% first-year bonus depreciation is allowed on new property subject to the Modified Accelerated Cost Recovery System (MACRS) that was acquired and placed in service after December 31st, 2011, and before January 1st, 2013 (before January 1st, 2014 for certain longer-lived and transportation property). First-year bonus depreciation is allowed for both regular tax and alternative minimum tax purposes. After deducting the bonus depreciation, an allowance is calculated on the remaining basis using the appropriate recovery period, method and convention.

In general, an asset qualifies for first-year bonus depreciation if the following conditions are met:

* New MACRS property with a recovery period of 20 years or less;
* Property must be placed in service before January 1st, 2013. (Certain long-production-period property and certain transportation property may be placed in service before January 1st, 2014); and
* Original use of the property commences with the taxpayer.

2012 TRA - Extends the 50% first-year bonus depreciation to qualified property acquired and placed in service before January 1st, 2014 (before January 1st, 2015 for certain longer-lived and transportation property). First-year bonus depreciation also applies to qualified leasehold improvement property, qualified restaurant property, and qualified retail property.

Code Section 179 Expensing Boosted for 2013: In addition to the first-year bonus depreciation, a taxpayer can elect to deduct a portion of the cost of qualifying property instead of depreciation as long as they are used in the taxpayer's business (subject to spending and income limitations). Amounts in excess of the limitations, can be carried forward and expensed in a subsequent year or can be recovered through depreciation based upon the recovery period, convention and method.

Prior to the new law, the maximum that could be deducted in 2012 was $139,000 (this amount was down from the 2011 threshold of $500,000). For tax years beginning after 2012, the maximum amount was $25,000. The investment ceiling was also significantly reduced for 2012 versus 2011 ($560,000 versus $2 million). For tax years beginning after 2012, the investment ceiling was further reduced to $200,000.

Property that is eligible under IRC Â§179 had to be:

* Tangible personal property (Code Sec. 1245) depreciated pursuant to the MACRS regardless of recovery period; and
* For any tax year beginning in 2010 or 2011, up to $250,000 of qualified real property could be expensed (qualified leasehold improvement property, qualified restaurant property, and qualified retail improvement property).

It should be noted that a taxpayer can opt-out of IRC Â§179. However, this election is irrevocable and cannot be claimed on a retrospective basis utilizing the Change of Accounting Method procedure.

Part two will appear in the February 26th edition of the New York Real Estate Journal's New York City Finance section.

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