nyrej

New regulations are more complicated but offer benefits

March 24, 2014 - New York City

Real estate owners are finally allowed to write off the remaining value of retired structural improvements. This change can significantly reduce taxable income in those periods where major replacements of structural components are completed. But wait, it gets even better! By writing off the basis of the retired assets, the owner will not be subject to depreciation recapture taxes upon sale on non-existent assets.

Most seasoned properties have extensive depreciation schedules with one or more roof replacements or HVAC upgrades that litter the depreciation schedule. The new regulations allow owners to retroactively adopt these rules. To implement this new strategy, tax professionals should identify those legacy improvements that resulted in a concurrent retirement. Furthermore, this process should also pave the way for prospective write-offs.

Sophisticated owners already understand cost segregation. This is just another step in the direction toward marrying tax regulations to the life cycle of improved property. For those that choose to side-step this opportunity, be prepared to pay more in taxes.

Background

Prior to the enactment of this game changer, real estate owners were required to continue depreciating the retired HVAC unit, ductwork, elevator, roof covering, partitions, windows, doors, etc. when a replacement was needed. As such, owners had to depreciate the new item and the old item simultaneously. This rule defied logic in as much that owners were required to depreciate non-existent improvements. Furthermore, since owners were unable to remove these retired components from tax schedules, they would pay higher taxes in the event of a sale.

New World Order

The new rules are complex and require more record keeping, several annual elections, and several changes of accounting. Furthermore, the new regulations avail owners with de minimis safe harbor options. (These safe harbor rules allow taxpayers to deduct certain costs, under a specific threshold without challenge, as long as specific annual elections have been selected.) To meet the requirements, tax advisors will most likely increase fees to comply. However, the benefit should more than outweigh the additional cost. The expanded recording keeping requirement will result in the establishment of new accounts in the books and records to capture those costs that can be immediately deducted. Furthermore, greater dialogue with tax advisors regarding current year improvements and corresponding abandonments will yield benefit.

Another tip...Make time to discuss new projects with a tax advisor throughout the year. Before signing that next construction contract, make sure the architect and CM are on the hook for delivering a more detailed requisition that highlight costs, such as removal costs and demolition expenses, which are now deductible with "no limits."

How to Get Started

Ask a tax advisor to come in and discuss these opportunities before he or she completes the 2013 return. Establish a protocol that places a tax advisor in the loop anytime a significant capital expenditure is contemplated. Make sure internal accountants are up to speed on implementing the new rules, and make sure before the final requisition payment is made that the detail is sufficient to help support current and future write-offs.

Mark de Stefanis, CCA, SCSP, is president of Construction Cost Recovery, Inc., White Plains, N.Y.