



An analysis of a partial disposition election with respect to depreciable property

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This article discusses the partial disposition election with respect to depreciable property. These rules allow the remaining depreciable basis of an asset to be written off when that asset is disposed of, i.e. replaced. Prior to these rules, when an asset, say a roof, was replaced, the old roof was removed, a new roof was installed, and you continued to depreciate the old roof over its remaining life in addition to depreciate the new roof over its useful life. These new rules which are taxpayer friendly allow the old roof when replaced to be treated as a disposition and the remaining basis to be written off. This allows an immediate loss on the replacement of a component of the building instead having to wait until the entire building is disposed of.

The IRS issued final regulations providing rules for how to determine gain or loss when property subject to depreciation is disposed of, how to determine the asset disposed of, and how to account for partial dispositions of depreciated property. The regulations apply to property that is subject to depreciation under the modified accelerated cost recovery system (MACRS) and to tax years beginning on or after January 1, 2014.

A disposition of a portion of an asset is treated as a disposition on which gain or loss is realized only if the partial disposition election is made, except that the following dispositions of a portion of an asset are dispositions whether or not a taxpayer makes a partial disposition election:

- * Sale of a portion of an asset.
- * Disposition of a portion of an asset as the result of a casualty.
- * Disposition of a portion of an asset for which gain (determined without regard to depreciation recapture) is not recognized in a like kind exchange or involuntary conversion.
- * Transfer of a portion of an asset in a "step-in-the-shoes" nonrecognition transaction described in Code Sec. 168(i)(7)(B).

The partial disposition election may be made for any portion of a disposed-of asset regardless of how small the portion is. In addition, the removal costs may be deducted if the partial disposition election is made.

The partial disposition election must be made by the due date (including extensions) of the original federal return for the year in which the portion of the asset is disposed of. No formal election statement is required. The taxpayer simply reports the gain or loss on the disposed portion of the asset on the return. The partial disposition election is not considered an accounting method change. If an asset is disposed of by sale, exchange, or involuntary conversion, gain or loss must be recognized under the applicable provisions of the Internal Revenue Code.

The facts and circumstances of each disposition are considered in determining what is the appropriate asset disposed of. The unit of property definition used for purposes of determining whether a cost is a repair or capital expenditure does not apply.

Items placed in service on different dates, such as additions or improvements to an asset are separate assets. For example, although a building is an asset, a new roof placed on a building is an asset.

If the IRS disallows a taxpayer's repair deduction for an amount paid or incurred for the replacement of a portion of an asset, the taxpayer can make the partial disposition election for the disposition of the portion of the asset affected by the IRS's adjustment.

If the taxpayer makes the partial disposition election or the transaction is otherwise considered a partial disposition, the adjusted basis of the disposed portion of the asset at the time of disposition needs to be computed to determine gain or loss. Any reasonable method may be used to determine the unadjusted basis of the disposed portion (i.e., the portion of the original cost of the asset that is allocable to the disposed-of portion), including the following:

- * Discounting the cost of the replacement portion of the asset to its placed-in-service year cost using the Consumer Price Index.
- * A pro rata allocation of the unadjusted depreciable basis of the asset based on the replacement cost of the disposed portion of the asset and the replacement cost of the asset.
- * A study allocating the cost of the asset of its individual components.

In light of these rules, it would appear that a cost segregation study should be strongly considered prior to closing.

A taxpayer may make a partial disposition election for tax years beginning on or after January 1, 2012, and ending on or before September 19, 2013, on an amended return if the election was not made on the taxpayer's timely filed original return. The amended return must be filed on or before 180 days from the due date of the 2012 or 2013 return (including extensions even if no extension was filed for).

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