Tangible Property Treatment Analysis

By Heidi Henderson, May 12, 2014

Many CPA's and taxpayers have been asking about the importance of the IRS's published guidance in regards to the proper treatment of repairs and improvements to tangible property. These regulations finalized in September of 2013 make significant changes that require a shift in accounting practices and tax elections for every business owner! However, the implementation of these final regulations provides a number of positive tax planning opportunities and additional write-offs.

Since their release in 2013, Engineered Tax Services has been able to apply these rules to many clients who have reaped significant benefits immediately, as well as assuring annual write-offs and compliance under these regs.

A few of the most taxpayer favorable changes include:

The removal of the "Plan of Rehabilitation Doctrine" which historically required businesses to capitalize all costs associated with an overall plan of improvement. Now repair costs incurred alongside larger improvements can be deducted as repair costs or routine maintenance, and to expound, the business owner is also allowed to review historical projects to identify repair costs which were previously capitalized, and correct that treatment. *The ability to make this correction, without amending returns is a significant change!*

What does this mean: Client X who purchased a building for $9M in 2002, and in 2012 remodeled the property for $3.2M, capitalized all costs. Through a Repair & Maintenance study, costs incurred for parking lot resurfacing, painting, roofing repairs, and an HVAC replacement were all identified as repair costs under these new regs. Thus the client filed FORM 3115 with an adjustment of $973,000 in additional deductions in 2013.

The annual disposition or retirement of assets is another section addressed in these regulations. The IRS has stipulated that businesses should dispose of or "write-off" long-term fixed assets at the time they are removed from their properties or are no longer in service. Historically taxpayers have continued to depreciate these assets long after they have been removed. The most common assets identified in a review are lighting systems, HVAC systems, roofs, tenant improvements, walls, and windows. These assets usually depreciate over 39 or 27.5 years, so disposition provides for a large adjustment in most cases.

What does this mean: Client X installed a new energy efficient lighting system in 2012, on a property purchased in 2002. The existing lighting system is 10 years old and has 29 years of depreciation left on the books. A disposition study finds the existing system to have a remaining basis of $275k, allowing the taxpayer an additional deduction of $275,000.

These changes have now made **Cost Segregation studies** more applicable than ever. These types of asset identification studies allow businesses to apply newer definitions such as smaller asset groups (or "Unit of Property's), repair & maintenance or routine maintenance costs to each asset group, and annual disposition due to the clear cut basis outlined in a detailed cost segregation study. Cost Segregation no longer provides only accelerated depreciation as a timing difference; rather it offers a **permanent tax savings position** by cutting costs in the following areas:

Engineered Tax Services provides specialty tax consulting services and engineering studies to apply tax code and IRS methodologies for depreciation, repair costs and fixed asset allocations, saving clients hundreds-of-thousands of dollars annually. If you have not reviewed your depreciation schedules or spoken with your tax professionals about these recent changes, call us today for a complimentary review to identify opportunities and take advantage of recent *favorable* changes.