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Tax planning opportunities available in an ever-changing tax world

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Beginning in 2013, rental income for partnerships, limited liability companies (LLC's), and sole proprietorships will be subject to a 3.8% income tax surcharge as portions of the Affordable Care Act begin to be implemented. With the maximum personal federal income tax rate rising to 39.6%, many taxpayers will find themselves paying federal income taxes at 43.4%. For retailers in states with personal income taxes, the tax bill could easily exceed 50%.

Rental income that flows to a C Corporation or a subchapter S Corporation is not subject to the 3.8% tax surcharge. Many large retailers, including many that are publicly traded, are C Corporations and will not be subject to the surcharge or maximum rates, but most retail taxpayers will be subject to the new rates.

Fortunately there are some excellent tax planning opportunities available for taxpayers to potentially lower their tax burdens. The four most common strategies retail taxpayers implementing are as follows:

* Bonus depreciation rules and yearly expensing options
* Cost segregation studies
* Energy-efficient tax deductions
* Application of the new "Repair vs. Capitalization" rules

Bonus depreciation and
expensing options

Bonus depreciation is one of many tax provisions Congress has enacted since 2001 that is very taxpayer friendly. Taxpayers may expense, in the year of acquisition, 50% of the cost of the asset and depreciate the remaining 50% of asset cost over the IRS prescribed life.

In addition to bonus depreciation, taxpayers are allowed to expense 100% of the cost of certain assets up to a certain dollar threshold limit. Generally a taxpayer may deduct asset purchases up to $500,000 per year, reduced dollar for dollar for asset purchases greater than $2 million. The bonus depreciation rules and expensing options are scheduled to expire at December 31.

Cost Segregation Studies

A Cost segregation study identifies and reclassifies personal property assets to shorten the depreciation time for taxation purposes, which reduces current income tax obligations.

Cost segregation studies can be completed for newly constructed or purchased assets. Placing the assets in the correct IRS prescribed life will also allow taxpayers to take advantage of both the bonus depreciation rules and expensing options.

Energy-efficient tax deductions

In 2005, congress passed the Energy Policy Act in an effort to develop a long-term national energy policy. One of the key provisions of the act enables taxpayers to receive a one-time tax deduction for constructing or renovating a building that results in energy savings of 50%. The maximum deduction is up to $1.80 per s/f. This means a 100,000 s/f energy-efficient building could be eligible for a tax deduction of up to $180,000.

Additionally, for buildings that don't quite meet the full qualification, the deduction can be broken out between 3 building systems. The $1.80 per s/f deduction is divided equally among the 3 building systems. This tax provision is also scheduled to expire at December 31.

The new repair

vs. capitalization rules

Beginning in 2014, all taxpayers will be required to adopt the new "repair vs. capitalization" rules. Under the new rules, many expenditures that taxpayers currently deduct 100% in a tax year as repairs and maintenance will now be required to be capitalized. However, one of the key provisions of the new rules that will benefit retailers is the requirement that taxpayers write-off assets previously capitalized when assets were replaced, abandoned, demolished, or otherwise disposed of, which will typically provide a substantial tax write-off. This will be particularly valuable to retailers who, in the past, have been aggressive in taking repair or maintenance deductions for expenditures for assets that now will be required to be capitalized.

Summary

The tax laws are complicated and with no "tax simplification" legislation in sight, taxpayers, and in particular, real estate owners have a number of tax reduction strategies available to them in addition to what is discussed above. Of course, with opportunity comes complexity and rules, and taxpayers would do well to adopt a comprehensive long-term real estate strategy to take advantage of the current tax laws and understand the risks involved.

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Jeffrey Hiatt is director of new business development and Philip Mann, managing director at MS Consultants, LLC, Williamsville, N.Y.