



nerej

Four ways owners and developers can lower taxes on commercial real estate

October 24, 2013 - Spotlights

Would you rather keep money for yourself or share it with Uncle Sam?

While we might all prefer to keep the money, many commercial property owners and developers share more than they need to with Uncle Sam, because they are unaware of tax-saving opportunities.

Four of the most often overlooked opportunities include:

- * Credits for brownfields
- * Historic rehabilitation credits
- * Classification of repairs vs. capitalization
- * Cost-segregation studies

These four opportunities, which are typically considered when developing a tax-planning strategy, can save owners and developers hundreds of thousands or even millions of dollars.

Brownfields. Under Massachusetts General Law Chapter 21E, if you buy or control polluted property, or if someone contaminates property you own, you're responsible for cleaning it up. While virtually anyone who owns commercial property in Massachusetts knows that, many owners don't know that they may be able to get the state of Massachusetts to split the cost.

A tax credit included in the Brownfields Act: Chapter 206 of the Acts of 1998 was created as an incentive for developers to reclaim polluted property, as well as to stimulate economic growth by restoring abandoned properties and putting them back into use. The credit is scheduled to expire on Jan. 1, 2014 so time is of the essence.

If a project fails to qualify for the 50% credit, it may still qualify for a 25% credit if the owner specifies allowable and prohibited uses for the property. The tax credit is transferable and can be carried forward for up to five years, so even companies with projects that fail to qualify may be able to save money by buying credits from other companies.

Historic Rehabilitation Credits. Rehabilitation of property in a historic district is eligible for a 20% state and federal tax credit. However, development in a historic district is subject to close oversight. In Boston, for example, the Boston Landmarks Commission oversees such development.

Buildings outside of a historic district are still eligible for a 10% rehabilitation tax credit, though, if they were built before 1936.

Repair vs. Capitalization. When a project qualifies as a repair, the entire expense can be taken in that year. When it is a capital improvement, it is typically depreciated over 39 years.

The Internal Revenue Service just recently released final repair vs. capitalization regulations. While these new final regulations narrow what qualifies as a repair, there are significant planning

opportunities. The largest planning opportunity gives taxpayers the ability to write off capitalized items that were replaced before being fully depreciated.

Taxpayers who capitalized rather than deducted their repairs and improvements may now be able to reach back and deduct the remaining carrying value as an expense.

For example, if a taxpayer is replacing a roof costing \$200,000, it must be depreciated over 39 years. This results in a \$5,000 tax deduction each year. However, a new roof is unlikely to last for 39 years. The IRS recognized this so, under the new regulations, the taxpayers can now write off the remaining carrying value of the roof that is replaced. The new regulations also allow for early adoption of the rules for a greater opportunity.

Cost-Segregation Studies. A cost-segregation study is a breakdown and analysis of all assets associated with a building. When a cost-segregation study is performed, depreciation of many costs can be accelerated. It's a way to more accurately measure the depreciation of real property for tax purposes. If no cost-segregation study is conducted, the commercial building you own will be depreciated over 39 years, using the straight-line depreciation method.

Land improvements, which include landscaping, sewers, paving and curbing, can be depreciated over 15 years. Personal property, such as finish carpentry, emergency power generators, cabinets and even certain HVAC units, can be depreciated in five or seven years.

When performed properly, the study should consider potential deductions for hundreds or even thousands of components, including electrical outlets, wood trim, pipes and countertops. By segregating these costs, typically 10% to 30% of the purchase price of a building can be reallocated for depreciation over shorter periods.

Given the cost of commercial development, the right tax-planning strategy can save owners and developers significant dollars.

Donald Greenhalgh and Jonathan Farrell are partners in the real estate practice group at DiCicco, Gulman & Co., Woburn, Mass.