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Real estate owners and developers must keep informed about tax and accounting changes

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The year is halfway through and it's time to take a look forward at some of the most important tax and accounting changes as we approach 2015. From new repair vs. capitalization rules to upcoming changes from the Financial Accounting Standards Board regarding lease accounting, owners and developers face a lot of change and uncertainty as we head towards 2015.

New Repair vs. Capitalization Rules

The new repair vs. capitalization rules went into effect in 2014 and they represent a huge change in the tax world. After a decade-long debate, the IRS has established new regulations which significantly change the approach that must be taken when deciding whether an expenditure is capitalized or expensed. The new rule will likely result in more expenditures being capitalized, which could mean a higher tax bill.

The new rules also establish a de minimis Safe Harbor. This safe harbor allows a taxpayer to write off expenditures when certain conditions are met. A taxpayer who has an audited financial statement may expense up to $5,000 per item or invoice as long as they have expensed the item or invoice for book purposes under a documented capitalization policy. Taxpayers without audited financial statements may only write off amounts up to $500 under this safe harbor. The taxpayer can set a threshold amount in its capitalization policy that is lower than the ceiling amounts. In addition, taxpayers can still expense repairs over the safe harbor amount, but the IRS may challenge the categorization. There are additional considerations with the safe harbor, and a tax advisor should be consulted.

These rules have both risks and benefits for taxpayers. In order to properly adopt and implement these new regulations, close coordination with your tax advisor is essential.

Expired Extenders

Two important tax provisions that are relevant to real estate expired in 2013; 50% bonus depreciation and the 15 year recovery life for Qualified Leasehold Improvements (QLI). The 50% bonus depreciation permitted a 50% deduction on property classed under the Modified Accelerated Cost Recovery System (MACRS) with a life less than 25 years. The 15 year recovery life for QLI permitted a 15 year write-off of QLI, as opposed to 39 years without the provision.

These provisions expired in December 2013. Congress is currently in the process of developing "extender" bills, but they are not expected to be passed until November 2014 at the earliest, or if at all. If the extender bills are made retroactive to January 2014, taxpayers may see no real effects; if not, there will be negative effects for taxpayers. In particular, qualified leasehold improvements and restaurant improvements may take a hit, as there is no immediate cost benefit to making improvements.

Lease Accounting Policies

Finally, for anyone required to report results under GAAP (Generally Accepted Accounting Principles) the Financial Accounting Standards Board (FASB) continues to work accounting for leases. These changes will not take place until 2017-2018 at the earliest, but lessors required to report under GAAP should start considering the impact on how they lease now. The proposed models are less straightforward and more complicated than current accounting standards, for both the lessor and the lessee. Lessors should also pay attention to how the lessee will be required to account for their side of the leasing transaction, since some of the proposed changes may affect tenants decisions on leasing transactions..

Tax and accounting rules are not usually considered to be exciting, but real estate owners and developers may find that life gets a little too exciting if they aren't aware of the changes in the tax and accounting world. You don't have to try to understand it all alone - an accounting firm can help you understand and comply with the new rules and regulations of 2014.

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