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## Capitalizing On New Maintenance And Expense Regulations In Real Estate

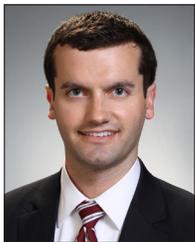
### How To Get Significant Tax Savings

BY ERIC R. ALLON AND ALLEN D. HANKINS  
SPECIAL TO BANKER & TRADESMAN

In September of last year, the Treasury Department released final regulations that clarify which business expenses may be deducted in a single year, such as maintenance and repair costs, and which expenses must be capitalized over numerous years, such as improvements. These new regulations went into effect Jan. 1, and they present several tax-advantaged opportunities in the real estate context.



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Perhaps one of the biggest opportunities to decrease taxable income under the new regulations is contained within the building routine maintenance safe harbor provision. Under this safe harbor, a taxpayer may deduct expenses paid for routine activities that the taxpayer expects to perform to keep a building and its structural components (including building systems, such as HVAC, plumbing, electrical and elevators) in their ordinarily efficient operating condition. Activities are considered “routine” if, at the time the building is placed in service, the taxpayer reasonably expects to perform such maintenance more than once over a 10-year period.

This safe harbor can translate to significant, immediate tax savings. The regulations provide various examples applying the safe harbor, including one relating to an HVAC

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system. If a landlord owns an office building, the HVAC is considered a building “system.” If the system requires maintenance by an outside contractor every four years, including disassembly, cleaning, inspection, repair and replacement of the system and its component parts, the expenses in connection with that maintenance may be deducted under the routine maintenance safe harbor. If an inspection discloses a problem with a component costing \$2,000, and the component is repaired or replaced with a comparable replacement part, the full \$2,000 may be deducted in a single year instead of depreciating it over several years.

#### Maximizing Tax Savings

In order to maximize potential tax savings under this safe harbor, taxpayers should identify the cost of maintenance activities that past experience would allow them to reasonably expect to perform more than once in 10 years. The IRS has already clarified that it is not problematic if the taxpayer does not actually perform the maintenance more than once in 10 years, so long as there was a reasonable expectation at the time the building was placed into service by the tax-

payer that such maintenance would be so performed.

A second opportunity for a landlord to decrease taxable income is under the new de minimis safe harbor regarding the acquisition of real or personal property. Taxpayers with an applicable financial statement (AFS), such as a certified audited statement prepared by an independent CPA, may be able to deduct up to \$5,000 for the cost of acquired property per invoice, or per item if substantiated by an invoice. For taxpayers without an AFS, the limit drops to \$500. For instance, if a landlord of a multifamily property buys 300 refrigerators, each for \$400, he could potentially deduct the entire \$120,000 cost (even if the landlord does not have an AFS since the per-item cost falls below the \$500 threshold). The safe harbor also requires that the taxpayer have a corresponding written capitalization policy in effect at the beginning of the tax year and that the taxpayer annually elect that the safe harbor apply.

As with any tax rules, the new regulations are complex and have various requirements applicable to specific situations, including issues related to improvements versus repairs, whether demolition and removal costs are capitalized and whether a party even qualifies for various safe harbors. To navigate these new rules, interested parties should seek the advice of their counsel and accountants as soon as possible to ensure compliance with the new rules and the most favorable tax result. ■

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