The Bankler Report

March 3, 2011

INTRODUCTION

This report assists clients in the utilization of the 100% Bonus Depreciation in effect thru December 31, 2011. Business acquiring qualifying assets can write off the entire cost of these assets if placed into service by year end.

Qualifying Assets.

Generally, NEW tangible personal property (furniture, fixtures, equipment, and certain vehicles (SUVs, trucks, and vans with gross vehicle weight over 6,000 pounds)) that has a depreciation (recovery) period of 20 years or less.

Generally, real estate is NOT eligible for this provision, except for certain "qualifying leasehold improvement" property.

Qualifying Leasehold Improvement Property.

This property MUST be subject to a lease. The improvement may be made by EITHER the landlord or tenant. The improvement is placed into service more than 3 years after the date the building was placed into service. The following improvements will **NOT** qualify: (a) enlargement of the building, (b) an elevator or escalator, (c) any structural component benefiting a common area, and (d) the internal structure framework of the building.

Identifying Qualifying Personal Property Constructed as part of a "New Building".

In the depreciation context, there is no stand-alone definition of "personal property." Instead, the Treasury Regulations say the term is defined the same way "tangible personal property" is defined for the repealed investment tax credit (ITC).

Cost segregation studies. Commercial building owners often conduct detailed cost segregation studies or analyses to distinguish "personal property" items from "real property" items. Such studies will be valuable assets for businesses or investors that build, renovate, or expand commercial properties this year.

The leading case on the issue is Hospital Corp of America & Subsidiaries, (1997) 109 TC 21, in which the Tax Court held that realty-related property is tangible personal property for depreciation purposes if it would have been classified by the courts as tangible property for ITC purposes. The Tax Court OK'd quick writeoffs for a wide variety of assets, including part of the cost of the primary and secondary electrical distribution systems (as well as a portion of other electrical components), carpeting, vinyl wall coverings, and accordion-style room partitions. IRS acquiesced in the Hospital Corp holding that the tests developed under the ITC are applicable in determining whether an asset is a structural component for purposes of depreciation.

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IRS Guidance on "New Building's Personal Property Components".

IRS has published a series of Field Directives on the planning and examination of cost segregation issues in various industries (restaurant, casino, retail, pharmaceutical, auto dealership — see links below to IRS website) that categorize a wide array of assets as either "real property" that must be written off over 39 years (or over 15 years, if it is a qualifying land improvement) or "tangible personal property" that is depreciable over 5 or 7 years depending on the type of asset.

The Field Directives say that if a return position for enumerated assets is consistent with the Directives' recommendations, examiners should not make adjustments to the categorization of assets or their recovery period.

"New Building" Assets Qualifying for 100% write off.

The following are some of the more widely applicable types of assets classified as having shorter recovery periods by the Field Directives, and therefore eligible for a 100% first-year write off if they otherwise qualify.

- *Canopies and awnings*. Readily removable equipment or apparatus used for providing shade or cover. Includes canopies that are largely decorative, but not canopies that are an integral part of a building's structural shell.

- *Decorative millwork*. This is decorative finished carpentry, examples of which include detailed crown moldings, lattice work placed over finished walls or ceilings, and cabinets. Decorative millwork serves to enhance the overall décor of the business (e.g., restaurant, casino) and is not related to the operation of the building. (Cabinets and counters in a restroom are excluded from this category.)

- *Doors*. Special lightweight, double action doors installed to prevent accidents in a heavily trafficked area (e.g., "Eliason" type door). For example, flexible doors, clear curtains, or strip curtains used between stock areas and selling areas.

- *Electrical outlets*. Only those outlets specifically associated with particular items of machinery and equipment (as opposed to operation of the building as a whole).

- *Electrical connections*. Special electrical connections which are necessary to and used directly with a specific item of machinery or equipment or connections between specific items of individual machinery or equipment, such as dedicated electrical outlets, wiring, conduit, and circuit breakers by which machinery and equipment is connected to the electrical distribution system.

- *Facades in interior of building*. Facades, such as a false storefronts, made primarily of synthetic materials (foam, fiberglass, cast stone, or glass reinforced concrete) that are not permanently attached and not intended to be permanent. This category would include false balconies, as well as finishes on interior columns that are not permanently attached and not intended to be permanent.

- *Fire protection equipment*. This includes special fire detection or suppression systems directly associated with a piece of equipment. For example, a fire extinguisher designed and used for protection against a particular hazard created by the business activity (e.g., a restaurant).

- *Floor coverings*. Only if not permanently attached and not intended to be permanent, such as vinyl composition tile installed with strippable adhesive, sheet vinyl, and carpeting.

- *Foundations or footings, concrete*. Foundations or footings for signs, light poles, canopies and other land improvements have a 15-year depreciation period.

- *Heating, ventilation, and air conditioning (HVAC)*. The HVAC unit must meet the sole justification test (i.e., machinery the sole justification for the installation of which is that it is required to meet temperature or humidity requirements that are essential for the operation of other machinery (such as lifts in a car dealership) or the processing of materials or foodstuffs (in a kitchen setting)). A HVAC unit may meet this test even though it incidentally provides for the comfort of employees, or serves, to an insubstantial degree, areas where such temperature or humidity requirements are not essential.

- *Kiosks*. These are small, often prefabricated, retail outlets that aren't permanent.

- *Landscaping & shrubbery*. This is landscaping (including irrigation systems) that will be replaced contemporaneously with a related depreciable asset or that will be destroyed when the related depreciable asset is replaced. Examples: depreciable landscaping, shrubbery, trees, plant foliage, or sod placed around a parking lot. Such assets also have a 15-year depreciation period.

- *Light fixtures, interior*. These are light fixtures that are decorative in nature and not necessary for the operation of the building. In other words, if all the decorative lighting were turned off, the other sources of lighting would provide sufficient light for the building.

- *Lighting, exterior*. Lighting that highlights only the landscaping or building exterior (but not parking areas or walkways), as well as plant grow lights, and that does not relate to the operation or maintenance of the building.

- *Lighting, exterior, pole mounted*. Outdoor lighting systems that are pole mounted or freestanding and serve to illuminate sidewalks, parking or recreation areas have a 15-year depreciation period.

- *Music and public address (PA) system*. Equipment and apparatus used to provide amplified music or sound; also includes wiring. Does not include a PA system that is an integral part of a fire protection system.

- *Parking lots*. Grade level surface parking areas built of asphalt, brick, concrete, stone or similar material have a 15-year depreciation period. This category includes bumper blocks, curb cuts, curb work, striping, landscape islands, perimeter fences, and sidewalks. However, IRS has said that open-air parking structures providing multi-level parking accessed by a ramp system are real estate structures and therefore are depreciable over 39 years.

- *Poles and pylons*. Light poles for parking areas and poles used in concrete footings or bolt-mounted for signage have a 15-year depreciation period.

- *Plumbing and similar hookups*. Water, gas, or refrigerant hook-ups, if directly connected to appliances or equipment needed for a particular type of business (e.g., restaurant or hair salon).

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- *Security equipment*. Includes electronic article surveillance systems including surveillance cameras, recorders, monitors and related equipment, that have as a primary purpose the minimization of theft in retail areas.

- *Signs*. Interior and exterior signs used for display or theme identity, and any signage not pertinent to the operation of the building. Does not include exit signs.

- *Site grading*. All of the following assets have a 15-year depreciation period, and therefore qualifies:

  - Clearing, grading, excavating and removal costs directly associated with the construction of sidewalks, parking areas, roadways and other depreciable land improvements.

  - Site work, including site drainage, sewers, roads, sidewalks, paving, curbing, general site improvements, site fencing and enclosures, and other site improvements not directly related to the building.

  - Patio stonework embedded in the ground and applied to exterior half walls that are not an integral part of the building's structural shell.

- *Walls, if movable*. These are interior (partition) walls built so that they can be (1) readily removed and remain in substantially the same condition after removal as before, or (2) moved and reused, stored or sold in their entirety.

- *Wall coverings*. Includes strippable wall paper and vinyl that causes no damage to the underlying wall or wall surface.

- *Window accessories*. Window accessories such as drapes, curtains, louvers, post-construction tinting that is readily removable, and interior decorative theme decor.

Reference Links on IRS website:

- Cost segregation field directive on casinos
http://www.irs.gov/businesses/article/0,,id=134685,00.html.

- Cost segregation field directive on restaurants
http://www.irs.gov/businesses/article/0,,id=134686,00.html.

- Cost segregation field directive on retail industries
http://www.irs.gov/businesses/article/0,,id=134687,00.html.

- Cost segregation field directive on pharmaceutical and biotechnology industries
http://www.irs.gov/businesses/article/0,,id=153520,00.html.

- Cost segregation field directive on the auto dealership industry
http://www.irs.gov/businesses/article/0,,id=180233,00.html.

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