



Carrara
Business Services

**NJ Self Storage Association
Annual Meeting
3/16/16**

Tax Saving Strategies

**IRS Tangible Property Regulations
Cost Segregation**

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Reg. 1.162-3. Materials and Supplies

Definition of Materials and Supply

Tangible Property that is used or consumed in Taxpayers operations that is NOT inventory.

- ❖ Unit of Property (UOP) costing less than \$200.
- ❖ UOP has an economic useful life of 12 months or less.
- ❖ Fuels, lubricants, water, etc reasonable expected to be consumed in 12 months or less.
- ❖ Component acquired to maintain, repair, or improve a UOP and that is not acquired as part of any single UOP including rotatable, temporary and standby emergency spare parts.
- ❖ Identified by other IRS guidance.

Reg. 1.162-3. Materials and Supply

Reg. 1.162-3(a)(1). Non-incidentaM&S.

- ❖ Non-incidentaM&S are deductible in the tax year in which the materials and supplies are used or consumed in the taxpayers operations.

Reg. 1.162-3(a)(2). IncidentaM&S.

- ❖ IncidentaM&S that are carried on hand for which no record of consumption is kept and no physical inventories are taken are deductible in the tax year they are paid or incurred.

Materials and Supplies Examples

Self Storage Examples

- Office Supplies (paper, toner, etc)
- Lighting Supplies (bulbs, tubes, etc)
- Packing Supplies (boxes, packing material, etc) ?
- Locks ?

Reg. 1.263(a)-1(f) DeMinimis Safe Harbor Election

- ❖ Annual Election
- ❖ Allows for immediate Expensing of items that may otherwise be capitalized.
- ❖ AFS - \$5000
- ❖ Non-AFS
 - \$500 in 2015
 - \$2500 in 2016 (See Notice 15-82)
- ❖ Expensing vs. 179
 - Expense before considering 179
 - 179 goes on depreciation schedule & depreciation recapture

Reg. 1.263(a)-1(f) DeMinimis Safe Harbor Election

Taxpayers without AFS (Applicable Financial Statement)

- ❖ Taxpayer has at the beginning of Tax Year, accounting procedures treating as an expense for non-tax purposes. (Book must match Tax)
 - Amounts paid for property costing less than specified dollar amount; or
 - Amounts paid for property with an economic useful life of 12 months or less.
- ❖ Taxpayer treats the amount paid for the property as an expense on its books and records in accordance with these accounting procedures
- ❖ Amounts paid for the property does not exceed \$500 (\$2500) per invoice (or per item if substantiated by the invoice)

Reg. 1.263(a)-1(f) DeMinimis Safe Harbor Election

Transaction and Other Costs

- ❖ Must include additional costs (delivery fees, installation services, etc) IF these costs are on the same invoice. Allocate by reasonable method if lump sum.

Exceptions to De Minimis Safe Harbor

- ❖ Land
- ❖ Inventory
- ❖ Rotable, temporary and standby emergency spare parts that the taxpayer elects to capitalize and depreciate.
- ❖ Rotable and temporary spare parts that the taxpayer accounts for under the optional method of accounting.

De Minimis Expense Safe Harbor Examples

Self Storage Examples

(Based upon \$2500)

- 10 computers for \$15,000
- \$25,000 of Office Furniture
- \$2400 golf cart
- \$1200 ergonomic office chair for owner
- IRS Notice 15-82

Reg. 1.263(a)-3(i).Routine Maintenance Safe Harbor

Routine maintenance for Buildings

- ❖ Recurring activities that a taxpayer expects to perform as a result of the taxpayers use of owned property, ... to keep the building structure or each building system in its ordinarily efficient operating condition.
- ❖ Routine includes: cleaning, testing, replace worn parts, etc.
- ❖ Activities are deemed routine ONLY if the taxpayer reasonably expects to perform the activities “more than once during a ten year period”.

Routine maintenance for Non-Buildings

- ❖ Expects to perform the activities more than once during the class life. Class life is different than depreciation life.

Reg. 1.263(a)-2f et al. Acquisition Costs

- ❖ Taxpayer must capitalize the amounts paid to acquire or produce a UOP, including leasehold improvements, land and land improvements, buildings, equipment, furniture and fixtures... including costs for work performed prior to date that the UOP is placed in service by the taxpayer.
- ❖ Taxpayer must capitalize amounts paid to FACILITATE the acquisition of real or personal property.
- ❖ The amount paid in the process of investigating or otherwise pursuing the acquisition... is INHERENTLY FACILITATIVE.
- ❖ Investigation costs are generally NOT facilitative.
(Capitalization begins once offer put it)

Reg. 1.263(a)-2f et al. Acquisition Costs

Costs that are **INHERENTLY facilitative**:

- ❖ Transporting the property
- ❖ Securing an appraisal or determining the value/price
- ❖ Negotiating the terms or structure of deal and tax advice
- ❖ Application fees, bidding costs, etc.
- ❖ Preparing documents that effectuate acquisition of property
- ❖ Exam and evaluate title of property
- ❖ Obtaining regulatory approval, permits, app fees.
- ❖ Conveying property between parties. (transfer tax)
- ❖ Finders fees that are contingent on successful acquisition
- ❖ Engineering, environmental, inspection, etc services
- ❖ Services by qualified intermediary of a 1031 exchange.

Reg. 1.263(a)-2f et al. Acquisition Costs

- ❖ Employee compensation and overhead are treated as amounts that DO NOT facilitate the acquisition of real or personal property.
- ❖ A Taxpayer may “elect” to treat amounts paid for employee compensation and overhead as amounts that facilitate the acquisition of property.
- ❖ This election is made separately for each acquisition on timely filed, original tax return for tax year.
- ❖ This election may not be made or revoked by filing 3115.

Other Considerations (Not in TPR)

- Goodwill/Intangible (Tenant Leases) Example – Extra Space
- De minimis items part of transaction

What is a Unit of Property (UOP)

- ❖ UOP determination is based upon the “**FUNCTIONAL INTERDEPENDENCE**” standard. (FedEx case)
Buildings have special rules.
- ❖ Building as defined by Reg. 1.48-1(e)(1) is any structure or edifice enclosing space within its walls, and usually covered by a roof.
- ❖ Each Building and its structural components is ONE UOP.
- ❖ Improvement standards (BAR) must be applied separately to building structure or any of its defined building systems.
- ❖ Building Structure consists of the building and its structural components, other than the structural components designated as building systems. Building structural components includes such parts as walls, partitions, windows, doors, roof, ceiling, etc.

What is a UOP or Unit of Property

Building Systems are as follows:

- ❖ HVAC
- ❖ Plumbing
- ❖ Electrical
- ❖ Escalators
- ❖ Elevators
- ❖ Fire Protection and Alarm Systems
- ❖ Security Systems
- ❖ Gas Distribution System
- ❖ Other as defined by IRS

Reg. 1.263(a)-3 Amount Paid to Improve Property

Taxpayer generally must capitalize the aggregate of related amounts paid to improve a UOP.

- ❖ A UOP is “Improved” if the amounts paid for activities performed after the property is placed in service by the taxpayer (**BAR** Test):
 - Results in a “**B**etterment” of the UOP.
 - “**A**dapts” the UOP to a new or different use.
 - “**R**estores” the UOP.

Reg. 1.263(a)-3(j). Capitalization of Betterments

Taxpayer must capitalize amounts paid that result in the betterment of a UOP. It is a **Betterment** of UOP only if:

- ❖ **Ameliorates** a material condition or defect that either existed prior to the taxpayers acquisition of the UOP or arose during the production of the UOP, whether or not the taxpayer was aware of the condition or defect at the time of acquisition or production.
- ❖ Is for a **MATERIAL addition**, including a physical enlargement, expansion, extension or addition of a major component to the UOP or a **MATERIAL** increase in the capacity, including cubic or linear space of the UOP.
- ❖ Is reasonably expected to **MATERIALLY increase** the productivity, efficiency, strength, quality, or output of the UOP.

Reg. 1.263(a)-3(j). Capitalization of Betterments

Examples of Betterments

- Removal and remediation of land contaminated by prior owner underground gas tank. ?
- Reinforcement of columns and girders. ?
- Addition of a stairway and mezzanine. ?
- Replace 2 of 10 roof mounted HVAC units that were 10% more efficient. ?
- Addition of insulation that reduced energy cost by 50%. ?
- UOP has 40 – 10x10 driveup storage units
Takes 2 units and converts to 4 – 5x10 units.
Cost \$10,000. ?

Reg. 1.263(a)-3(l). Capitalization of Adaptations

Capitalization of amounts to Adapt property to a new or different use.

- ❖ Taxpayer must capitalize amounts paid to adapt a UOP to a new or different use. In general, an amount is paid to adapt a UOP to a new or different use if the adaptation is not consistent with taxpayer's intended ordinary use of UOP at the time originally placed in service.

Examples of Adaptations

- Convert warehouse to Self Storage.
(Date of Service)

Reg. 1.263(a)-3(k). Capitalization of Restorations

Taxpayer must capitalize the amounts paid to RESTORE a UOP.
An amount restores a UOP only if:

- ❖ Is for the replacement of a component of a UOP and taxpayer has properly deducted a loss for that component (other than a casualty loss);
- ❖ Is for the replacement of a component of a UOP and the taxpayer has properly taken into account the adjusted basis of the component in realizing gain or loss resulting from the sale or exchange of the component;
- ❖ Is for the repair of damage to a UOP for which the taxpayer has properly taken a basis adjustment as a result of a casualty loss, or relating to a casualty event;

Reg. 1.263(a)-3(k). Capitalization of Restorations

Cont.

- ❖ Returns the UOP to its ordinarily efficient operating condition if the property has deteriorated to a state of disrepair AND is no longer functional for its intended use;
- ❖ Results in the rebuilding of the UOP to a like-new condition after the end of its class life; or
- ❖ Is for the replacement of a part or a combination of parts that comprise a MAJOR component or a SUBSTANTIAL structural of a UOP.... (of the building structure or any one of its building systems, ie. HVAC)

Reg. 1.263(a)-3(k). Capitalization of Restorations

Buildings

Major Component:

A major component is a part or combination of parts that performs a discrete and critical function in the operation of the UOP. (ie. Roof)

An incidental component of the UOP, even though it performs a discrete and critical function in the operation of the UOP, generally will not, by itself constitute a major component.

Substantial Structural Part:

A substantial structural part is a part or combination of parts that comprises a large portion of the physical structure of the UOP.

Reg. 1.263(a)-3(k). Capitalization of Restorations

Examples of Restorations

- 100% Replacement of Roof Membrane at cost of \$100,000?
- Replace 1 of 1 HVAC unit total cost of \$75,000?
- Replace 3 of 10 HVAC units with total cost of \$75,000?
- Replace 100% of doors to Self Storage Building?
40 Driveup, 10' doors at \$1500 each to replace and total cost of \$60,000.

Special Rules for Improvement Costs

Reg. 1.263(a)-3(g)

- ❖ Taxpayer must capitalize all the direct costs of an improvement and all the indirect costs (including deductible repair costs) that directly benefit or are incurred by reason of an improvement.
- ❖ Indirect costs arising from activities that do not directly benefit and are not incurred by reason of an improvement are not required to be capitalized as an improvement regardless of whether the activities are performed at the same time as an improvement.

Example

- Office improvement of adding interior walls for individual offices require light fixtures to be moved.

Special Rules for Improvement Costs

Reg. 1.263(a)-3(g)

Removal Costs

- ❖ If a taxpayer disposes of a depreciable asset, including Partial Dispositions, then the costs of removing the asset or component are EXPENSED.
- ❖ Removal costs incurred by reason of repair or maintenance are EXPENSED.
- ❖ When a component is removed during an improvement, but the disposal of the component is not a disposition, then the Removal Costs must be CAPITALIZED as a cost of the improvement because it directly benefits and incurred by reason of the improvement.

Reg. 1.168(i)-8. Partial Asset Dispositions

Partial Asset Disposition (PAD)

- ❖ What is PAD? If during a **Capital** Improvement, you removed and discarded a building component (roof, walls, doors, HVAC, carpet, etc) you are permitted to write-off the remaining depreciation and write-off the building component from your depreciation schedule. If the project is "Expensed", you can't take a PAD.

Benefits:

- ❖ Immediate write-off of remaining depreciation.
- ❖ Future benefit when you sell the facility.
(Capital gains vs Depreciation Recapture)(5-10%)

How do you calculate Asset Basis Value?

- ❖ Cost Segregation
- ❖ Other methods, contact Carrara Business Services.

Summary

- ❖ 1st Step - Determine UOP
- ❖ Can you Expense under DeMinimis Safe Harbor (\$2500)
- ❖ If UOP is Building. Perform “BAR” test. Determine “Materiality” or Significance if applicable. Review IRS examples.
 - Restorations Less than 33%, Expense
 - Restorations Greater than 33%, Capitalize
 - Betterments that increase size, capacity, efficiency, quality, etc by 20+%, Capitalize. Less than 20%, Depends.
- ❖ If you Capitalize, get contractor to breakout invoice.
 - Expense Removal/Disposal cost of building component.
 - Contact Carrara-Cost Segregation for Partial Asset Disposition Calculation.

Carrara-Cost Segregation Services, Inc.

What is Cost Segregation

- ❖ Cost Segregation is an IRS-approved application by which commercial property owners accelerate depreciation and reduce the amount of taxes owed.
- ❖ It is a process of analyzing and identifying building components that are 5, 7 and 15 year property.
- ❖ Cost Segregation is a tax deferral strategy that provides a Positive Net Present Value (NPV) of future cash flows.
- ❖ It is best to do a Cost Segregation Study in the year the facility is purchased. However, still worth doing within 10 years of ownership. We will provide a preliminary analysis at no cost.

Carrara-Cost Segregation Services, Inc.

Why CSSI

- ❖ Completed over 13,000 studies.
- ❖ Detailed Engineering based Cost Segregation Studies that meet or exceed the IRS Audit Technique Guide.
- ❖ Compliant with IRS Tangible Property Regulations.
- ❖ All studies define the Building Systems as per IRS TPR.
- ❖ Audit and Inquiry Protection at no additional cost.
- ❖ No audits triggered and only 30-50 inquiries.
- ❖ No studies overturned.

Carrara-Cost Segregation Services, Inc.

Partial Asset Disposition

- ❖ Partial Asset Disposition can be done in conjunction with a Cost Segregation Study.
- ❖ Cost Segregation Study provides the costs breakouts for a CPA to take a Partial Asset Disposition for any future capitalized improvement.
- ❖ Carrara Business Services will do Partial Asset Disposition calculations at No Charge, for as long as you own the facility, when you do a Cost Segregation Study through Carrara Business Services.

Carrara-Cost Segregation Services, Inc.

Let's Review an Example

Energy Solutions – LED Lighting

Reduce your Lighting bill by 50+% with LED's.

\$10,000/yr Savings increases facility value by \$143,000 @ 7% CAP

Typically a 1-3 year payback

Tubes

- ❖ 3rd Generation or “Universal” Tube works with or without ballast. Don't purchase 2nd Generation Plug n Play. 1st Generation only works if you bypass the ballast.
- ❖ 15watts vs 32-40watts. Save \$7/yr/tube on average.
- ❖ NJ gives \$5/tube rebate. Cost \$20-25 each.

Wall Packs

- ❖ \$40/yr in electric savings on average.
- ❖ NJ gives \$50/wallpack rebate. Cost \$90-150 each.

Carrara Business Services alliance partner **GreenLight** is a full service provider. GreenLight is a distributor, installer and will submit for NJ rebate on your behalf.

Energy Solutions – Energy Procurement

Deregulation allows you to select your Electric and Gas Supplier.

- ❖ Save 10-15% in electric and/or gas.
- ❖ Prices quoted after bill analysis. Prices depend upon zip code, volume, time of day usage, etc.
- ❖ No cost to switch. Typically 12 month contracts.
- ❖ Current supplier (PSEG, JCP&L, etc) is still be responsible for transmission and billing. Carrara Business Services alliance partner AES has over 25+ providers bid to be your supplier. AES will manage/monitor your account.

Other Considerations

- ❖ Solar Panels. Carrara Business Services alliance partner Solar Renewable Energy. Provide turnkey project installation and will seek the best SREC's on your behalf. Typically a 3-5 year payback.

Carrara Business Services

Cost Segregation Studies

TPR Tax Consulting

Energy Solutions

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