CLARK SCHAEFER HACKETT
CPAs & BUSINESS CONSULTANTS

CASE STUDY - Disposition Study

Client: Midsize real estate developer
Topic: Tangible Property Regulations Compliance
Service: Disposition Study

The situation:

Our client is a real estate owner, manager, and developer whose core business revolves around large residential apartment complexes. The organization's business model relies on purchasing low to mid-end properties and performing significant renovations to create mid to high-end properties. Typically they hold the properties and manage them.

In early 2014, the client owned 27 properties purchased since 2002, each in its own entity, with a total acquisition cost of over $107M. The client had created one centralized entity to oversee the management of the various sister entities. To rehabilitate the properties, the client had spent over $22M on capitalized renovations which included improvements to roofs, signage, landscaping, HVAC, carpeting, lighting, swimming pools, windows, and parking lots, among others.

Over these years, in accordance with the existing tax regulations at the time, the client had not disposed of the replaced assets for tax purposes. Rather, the client was depreciating both the disposed assets and the new assets. Because the client treated all of their renovations in this manner, they were carrying an inordinate amount of no-longer used assets on their books.

The client's tax compliance was performed by another CPA firm, and they had previously filed the 2013 tax returns for many of their existing entities. Neither the client nor their existing CPA was aware of the opportunities presented by the final version of the tangible property regulations released in September, 2013. The regulations gave the client a limited window of opportunity to take a deduction for the disposal of assets that occurred prior to 2013, resulting in 2013 being the only available tax year to effectuate the changes.

Our solution:

Clark Schaefer Hackett advised the company to undertake a Disposition Study that would clarify the opportunities they now face in light of the finalized repair regulations. We examined prior disposition activity to determine which dispositions, or partial dispositions, had been made in cases where a deduction for the asset was never taken.

Then, using one of the reasonable methods outlined in the regulations, we calculated the cost of the disposed asset. We further determined the amount of remaining depreciation that could be deducted on the 2013 tax return for each disposition, and assessed the total tax impact of such deductions.

Finally, we examined 2013 capital expense activity to determine which items could now be expensed as repairs and maintenance under the new tangible property regulations.

The results:

CSH determined the client had total additional deductions of $5.97M for dispositions, and over $68,000 for repairs and maintenance. We prepared the necessary Forms 3115 for each relevant entity to allow the client to realize the entire tax benefit during the 2013 tax year.

We prepared a written summary of the above findings and activity, which included a detailed description of the legal support for our determinations, a narrative description of the changes being made, and a line-by-line calculation of the additional 2013 deductions. This report also included guidance on how to determine and calculate dispositions in the future.

Then we assisted the client's existing CPA in the filing of the Forms 3115 on both original and amended returns for the various entities, which ensured proper effectuation of the expected tax benefit.