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## **Deductibility of Leasehold Improvements under §179**

We have discussed §179 of the Internal Revenue Code in prior articles. Just to refresh your memory, this section allows a business owner to take an immediate depreciation deduction for qualified capital investments in the year that the assets are acquired. There are a few conditions to qualifying for deductibility under §179, such as: the equipment must be “placed in service” in the current year and the assets must be of a 15 year, or less, “depreciable class”.

As a reminder, the maximum allowable deduction for 2010 and 2011 was \$500,000; but was scheduled to drop back to its pre-2007 level of \$25,000 for 2012, unless enabling legislation was passed. The Jobs Act of 2010 reduced the maximum allowable deduction to \$139,000 for 2012; but this maximum deduction was increased back to \$500,000 for the years ending 2012 and 2013. The maximum deduction was due to return to \$25,000; but, thankfully, was extended permanently at \$500,000 under the “Tax Cut and Jobs Act of 2017”.

This section of the Code is still an important one for practices looking to invest in equipment, or tenant improvements, during this year.

I get a lot of questions on what type of investment qualifies for §179 Treatment. The resolution of this issue is pretty obvious when purchasing technology and other clinical equipment. The issue becomes nicer when it involves tenant improvements (TIs). This is because TIs are frequently associated with fixtures to the real property and thus confused with “39 1/2 Year Property” and not depreciable for tax purposes.

There has been a great deal of confusion in the health care community with regard to TIs and which of these are deductible. TIs can include cabinetry, walls of operatories, and plumbing, electrical, carpeting, painting and other typical renovations.

Some folks have been told that if improvements are fastened to the walls or floors they are fixtures and not deductible. This is incorrect. Other misinformation includes statements that cabinetry is only deductible if it has certain serial numbers!

The Treasury Regulations are promulgated by the Treasury Department and intended to provide tax professionals and courts with guidance as to how the Government interprets the current law (the Internal Revenue Code of 1986). The Regulations (or, “Regs”) help resolve ambiguities in the Code, with respect to TIs.

Deductibility under §179 requires that the improvements are “placed in service” during the tax year and are “15 Year Property”. There is no reason why wiring, plumbing and walls can’t be included in these definitions. The most important requirement for deductibility is the documentation. If the tenant/doctor keeps careful record of the expenditures in each area of the renovation/build out, the deduction of those expenditures will be upheld

Even though things like wiring and plumbing would seem to be fixtures and part of the real estate; they are investments in the practice itself and thus assets of the practice, deductible under §179. Again, the key is that these expenses are properly segregated in a simple Excel spreadsheet and supported by contractor invoices. If the expansion or renovation is very substantial (e.g. over \$100,000), it may be worth hiring an accounting or valuation firm to do a Cost Segregation Analysis (“Cost Seg”). A cost seg is prepared by a qualified valuation specialist and segregates all of the various expenditures into an IRS qualified report. You can do this yourself, as described above; but in the case of very large and complex renovations it may be worth the expense to obtain the cost seg, in order to bullet-proof your deductibility.

Even interior walls can be deducted as tenant improvements. Are you surprised? Why shouldn’t these improvements be deductible like surgical instruments?

The rule on interior walls, as between operatories, is that they are not “weight bearing”. If the walls are “bearing walls” they are deemed to be part of the building itself and thus not deductible.

The bottom line on improvements is that many of these expenditures will be depreciable for tax purposes and are likely to be deductible in the year that they are incurred, under §179.

It is important that you don’t let the “tax ‘tail’ wag the investment ‘dog’”. Don’t make investments in your practice because of tax benefits; but if you are thinking of making some improvements §179 can greatly reduce the time that it takes for you to realize a positive return on your investment.