Health Care Bulletin

Timely Year End Planning Could Result in Tax Savings

By Sefi Silverstein, CPA

Medical practices and related organizations planning for asset purchases such as equipment, computer software, furniture etc. (whether these acquisitions are purchased, financed or leased) should consider tax saving opportunities, especially those that are due to expire by year end. These tax savings opportunities also extend to physicians and business owners who own business and investment real estate, and apply to real estate acquisitions, improvements or renovations. Given the right circumstances owners may benefit by accelerating such cash expenditures. Below is a summary of some of these opportunities which include:

- Section 179 (an expense deduction limited to $500,000)
- Bonus Depreciation (an unlimited expense deduction- can be used if the $500,000 limit is reached)
- Cost Segregation Studies (for larger real estate expenditures)

Section 179

The cost of capital expenditures typically cannot be fully deducted in the year acquired. These assets are depreciated over their useful lives, as prescribed by IRS tables. However, named after the IRS code section, the Section 179 rules allow businesses to elect to fully deduct up to $500,000 of the cost of qualifying property, rather than depreciating the asset over time. Unless Congress extends or amends current law, the Section 179 expensing election is scheduled to be reduced to $125,000 for qualifying purchases in 2012 and $25,000 thereafter (adjusted for inflation).

For the asset to qualify for Section 179 treatment it must meet the following criteria:

- It must be tangible personal property (although, some real estate may qualify). Examples include medical equipment, computer software (EHR), office and computer equipment, office furniture, millwork, etc.
- **New and used assets** are eligible
- The asset must be acquired and placed in service by December 31, 2011

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Bonus Depreciation

For larger capital expenditures (or when Section 179 limitations apply) there is an opportunity through December 31, 2011 to take a full deduction on certain qualified property (known as "100 percent bonus depreciation"). Similar to Section 179, bonus depreciation provides a substantial deduction for business owners as they are generally allowed to deduct 100 percent of the cost of certain assets placed in service that would otherwise be required to be capitalized and depreciated over time. Under current law, 100 percent bonus depreciation is scheduled to expire December 31, 2011, and will be replaced with 50 percent bonus depreciation for expenditures incurred during 2012 and zero percent thereafter. (As of the writing of this article Congress is considering extending 100 percent bonus to 2012).

Bonus depreciation applies only to new (not used) assets. Additionally,

- The asset must be acquired and placed in service between September 9, 2010 and December 31, 2011, (or by December 31, 2012 for 50 percent bonus depreciation)
- The useful life of the asset, as prescribed by IRS tables, must be 20 years or less. Examples of qualifying assets include medical equipment, computer software (EHR), office and computer equipment, office furniture, millwork, qualifying SUV's , and certain land improvements such as parking lots, fencing, landscaping etc.

Section 179 and bonus depreciation provide an opportunity for practices to purchase, lease or finance assets described above and, if placed in service by December 31, 2011, to take a deduction for the full cost.

For the Real Estate Owner- Is it a Repair or a Capital Improvement?

When a property owner incurs costs in connection with improving or maintaining the property, one of the most common tax questions is whether that expenditure should be treated as a capital improvement or as a repair. For tax purposes, the cost of a capital improvement is recovered over time through depreciation deductions. Expenditures constituting repairs, on the other hand, are eligible to be fully deducted in the year incurred and provide an immediate tax benefit. In most instances, property owners prefer repair treatment. There are several factors that must be considered in order to make the proper determination.

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Factors that favor repair treatment:

- Does the expenditure merely maintain the building's existing condition?
- Does the expenditure restore the property to its previous condition?
- Does the expenditure constitute routine maintenance?
- Is the repair incidental to the property?

Factors that favor capital improvement treatment:

- Does the expenditure extend the life of the property?
- Does the expenditure improve the efficiency, quality, strength and/or capacity of the property?
- Does the expenditure increase the value of the property?

If the expenditure is treated as a capital improvement, the accelerated depreciation deductions (Section 179 and Bonus Depreciation) discussed earlier may apply and potentially fully mitigate the effect of having to capitalize the cost of the asset in the first place.

For Larger Real Estate Related Projects Consider a Cost Segregation Study (CSS)

Most commercial buildings such as medical arts buildings (MAB's), surgical centers, office buildings etc. and related improvements are depreciated over 39 years for tax purposes. For example, a $1 million building cost or improvement would only yield about $25,000 of an annual tax depreciation deduction.

Cost segregation involves the process of analyzing costs for the purpose of identifying shorter lived assets which qualify for five, seven, or fifteen year depreciable lives that are grouped within the total building costs, and then treating them as separate assets for tax purposes. Some of these qualifying costs may not be obvious to the property owner.

Shorter lived assets such as dedicated HVAC, fixtures, millwork, exam and operating rooms (including the special wiring, lighting, generators etc), land improvements and other components can be depreciated much more rapidly. Once these component assets are identified, not only are they eligible to be depreciated over a shorter period, but combined

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with the favorable depreciation rules described above, allow property owners to benefit from significant tax savings during the earlier years of the life of the property. A CSS can provide benefits to both existing and new properties, and for acquisitions and renovations in the current or prior years. The study also provides support for the allocation of assets in the event of an IRS audit.

Since property owners may not have the expertise or time, most retain accountants and engineers to conduct a thorough CSS. An initial evaluation (typically done at no cost) is recommended to determine whether or not the study will be cost effective and if the property owner will benefit from the accelerated depreciation deductions. In cases where a study is justified, the owners can benefit by incurring lower tax liabilities in current and future years, or receive tax refunds from prior years (for acquisitions or renovations made in earlier years). Benefits can far exceed the cost of the study.

Conclusion

Understanding your tax position as you approach the 2011 year end, in conjunction with projecting your tax position in the year(s) to follow, is a factor in implementing the above options. It's important to work with your tax advisors so you are positioned to take advantage of existing opportunities to save overall tax dollars on accelerated deductions and increase your return on investment.

Should you have any questions, please feel free to reach out to Wilkin & Guttenplan's health care experts at732-846-3000.

Any U.S. tax advice contained in this communication is not intended or written to be used, and cannot be used, for the purpose of avoiding tax penalties that may be imposed on the taxpayer.

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