NMHC NATIONAL MULTIFAMILY HOUSING COUNCIL

NAA NATIONAL APARTMENT ASSOCIATION

IRS REPAIR RULES

On Dec. 23, 2011, the Internal Revenue Service (IRS) issued temporary (T.D. 9564) and proposed rules (REG-168745-03) regarding the tax treatment of costs incurred in acquiring, maintaining and improving tangible property, including multifamily buildings. The regulations specify that expenses related to constructing or permanently improving a building, restoring property or converting property to an alternate use must be depreciated. However, the new rules allow taxpayers to deduct the cost of routine maintenance.

Although the IRS originally announced that the temporary regulations would be effective as of Jan. 1, 2012, the IRS said in Notice 2012-73 issued on Nov. 20, 2012, that taxpayers will not be forced to comply until 2014. The IRS's announcement also indicated that the agency expects to issue final regulations in 2013, which would also be mandatory beginning in 2014. The IRS also indicated that the final rules would amend sections in the temporary rules with respect to *de minimis* expensing and safe harbors for routine maintenance. On March 7, 2012, the IRS issued guidance (Revenue Procedures 2012-19 and 2012-20) that addresses how taxpayers may obtain the automatic consent of the IRS to change accounting methods to comply with the regulations.

Challenges and Complexities the Regulations Would Impose on the Multifamily Industry

The multifamily industry is extremely concerned that the IRS's regulations would create severe administrative cost burdens, result in noncompliance due to their complexity and disproportionately penalize older apartment communities, which tend to have higher repair costs. Furthermore, property owners may be less inclined to incur expenditures because of the considerable uncertainty over whether these amounts will be deductible in the year of the expenditure. This will slow the economic recovery by reducing job creation and employment for maintenance staff, contractors and the trades and suppliers providing equipment that service multifamily buildings.

NMHC/NAA Position

Although NMHC/NAA recognize the necessity for clear guidance to help taxpayers determine when to capitalize or expense costs associated with building property, the IRS should make final regulations set for issuance in 2013 more administrable and practical. To this end, we believe the IRS should amend the regulations by:

- **Adding Bright-Line Examples:** The temporary and proposed regulations rely on taxpayers to employ a fact-and-circumstances approach to compliance. Unfortunately, this will lead to significant confusion over whether an expense should be capitalized or expensed. The IRS should add bright-line examples on which taxpayers may rely before the regulations are finalized.

- **Expanding De Minimis Rule to Allow Additional Expensing:** The temporary and proposed regulations include a de minimis rule that allows only taxpayers who issue an Applicable Financial Statement (AFS) to third parties to expense, instead of capitalize, as repair costs the greater of 0.1 percent of the taxpayer's gross receipts for the year or 2 percent of the taxpayer's total depreciation and amortization expense. Entities not issuing AFSs, including many smaller multifamily operators, may only deduct materials and supplies that cost $100 or less. To avoid requiring operators to track literally every expense exceeding $100, the IRS should allow all entities to: (1) use the de minimis safe harbor; and (2) allow the automatic expensing of all costs up to $5,000.

- **Addressing Burdens Associated with Mandatory Accounting Changes:** The temporary and proposed regulations will force most affected taxpayers to change accounting methods by Jan. 1, 2014, to be in compliance. This will require taxpayers to file Form 3115, which entails taxpayers performing and attaching costly and extensive calculations that inform the IRS of changes in taxable income in the year of change and the two preceding years. In the interest of alleviating taxpayer burden and expense, NMHC/NAA recommend that the IRS require only taxpayers with significant levels of business income to undertake these additional calculations.

- **Treating Multiple Buildings in Development as Single Unit of Property.** Operators of development comprised of several buildings will find compliance even more burdensome, as every individual building is now treated as a separate unit of property. This will be a daunting task given that expenditures associated with each building and associated building systems must be kept up with separately. Accordingly, the IRS should consider multiple buildings within the same apartment community as a single unit of property for the purposes of these regulations.