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ACCOUNTANTS & ADVISORS

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PLACED IN SERVICE

When Tax Breaks May Apply to Retail Properties

The date that property is "placed in service" comes into play in several potentially beneficial federal income tax provisions, including those related to certain deductions and types of depreciation. In one Louisiana case, a taxpayer believed that a building could be "placed in service" before it actually opened its doors for business. The IRS disagreed, but the federal district court sided with the taxpayer.

GO Zone Deduction

The taxpayer in the case, *Stine LLC v. U.S.*, was a retailer that owned two buildings inside the Gulf Opportunity Zone (GO Zone). Certain GO Zone property was eligible for a 50% additional first-year depreciation deduction in the taxable year that the property was placed in service. The deduction was available only if the taxpayer's original use of the property began on or after Aug. 28, 2005, and the property was placed in service on or before Dec. 31, 2008.

Although the retail stores weren't yet open to the public on Dec. 31, 2008, they'd been issued certificates of occupancy. The certificates allowed personnel to install and stock equipment, shelving, racks and merchandise.

On its 2008 tax returns, the taxpayer claimed a GO Zone depreciation deduction. The depreciation created a loss for the year so the taxpayer carried back the losses to the 2003–2005 tax years and received a refund from the IRS for those years.

The IRS subsequently disallowed the GO Zone deduction and assessed the taxpayer taxes owed for 2003–2005 and 2008. The taxpayer paid those income taxes under protest and sued for a refund of $2.1 million.

State of Readiness

The IRS argued that the buildings weren't placed in service by December 31, 2008 because they weren't open for business. The taxpayer countered that the buildings were substantially complete and, therefore,

ready and available for their intended use of storing and housing equipment, racks, shelving and merchandise.

Federal tax regulations state that property is placed in service when it's "first placed in a condition or state of readiness and availability for a specifically assigned function." The regs specifically address the case of a building intended to house machinery and equipment and constructed, reconstructed or erected by or for the taxpayer and the taxpayer's use. In such a situation, the building is placed in service on the date the construction, reconstruction or erection is substantially complete and the building is in a condition or state of readiness and availability.

Available for Use

In addition, proposed Treasury Regulation Section 1.168-2(e)(3) provides that a building will be considered placed in service "only when a significant portion is made available for use in a finished condition (that is, when a certificate of occupancy is issued with respect to such portion)." And the IRS Audit Technique Guide for Rehabilitation Tax Credits states that a certificate of occupancy is one means of verifying the placed-in-service date for the entire building or part thereof.
The federal district court (whose ruling doesn't set precedent for other district courts) found that the IRS failed to cite any controlling legal authority to show that "placed in service" equates to "open for business." The taxpayer, on the other hand, provided undisputed evidence of the buildings' state of readiness. According to the court, the buildings "had been issued certificates of occupancy" and were ready "to receive shelving, racks, and merchandise." Thus, the court concluded, the buildings met the definition of "placed in service" and that a refund, therefore, was in order.

The Bottom Line

With placed-in-service requirements affecting the applicability of a number of tax-reducing provisions, this ruling could bode well for taxpayers who operate in the real estate arena. Your tax advisor can help you determine whether your properties may qualify for various credits and deductions.

Stine LLC v. U.S., No. 2:2013cv03224, Jan. 27, 2015 (W.D. La.)

IRS EXTENDS CONSTRUCTION DEADLINE ON CREDITS

In response to enactment of the Tax Increase Prevention Act of 2014 (TIPA), the IRS has updated its guidance on the "continuous construction" requirement for the renewable electricity production tax credit (PTC) and the energy investment tax credit (ITC). TIPA extended the date by which construction of a qualified facility must begin to be eligible for the PTC or ITC to January 1, 2015.

Previous guidance provided that a taxpayer may establish the beginning of construction by either starting significant physical work or paying or incurring 5% or more of the facility's total cost. Both methods require continuous progress toward completion once construction has begun.

Under the earlier guidance, this requirement is satisfied if a facility is placed in service before January 1, 2016. The new guidance extends the placed-in-service date to January 1, 2017. If a taxpayer began construction before January 1, 2015, and places the facility in service before January 1, 2017, the continuous construction requirement is satisfied.

IT'S A NEW DAWN

Key Considerations of Going Solar

With interest in solar power soaring in recent years, it's no surprise that some savvy commercial property owners with vast swaths of rooftop or other open space are determining whether to use some of that space for solar panels. While solar installations can cut operating costs and even create an additional revenue stream, they also come with some complex issues that require careful consideration.

Choose Your Approach

Several options are available for property owners interested in solar power. For example, you can install solar panels and use the power yourself, sell the power to tenants or both. You could also sell the power to a utility company. This additional revenue stream can increase the value of the property; however, this could also result in additional property taxes if the property is reassessed by local taxing authorities.

To avoid possibly steep upfront costs, consider entering into a power purchase agreement with a solar developer that installs, owns and operates panels on your property and sells the power to you. Or you can lease or license your roof or other space to a developer that will sell the power to other parties.

Look into a Tax Break

One of the current lures for solar investors is the investment tax credit, which is available to eligible taxpayers that install, develop or finance the project that uses the credit. The credit currently equals 30% of expenditures, with no limit, but is set to drop to 10% in 2017. Eligible solar energy property includes equipment that uses solar energy to generate electricity, to heat or cool (or provide hot water for use in) a structure, or to provide solar process heat. Hybrid solar lighting systems, which use solar energy to illuminate the inside of a structure using fiber-optic distributed sunlight, are also eligible. Passive solar systems and solar pool-heating systems, however, are *not* eligible.

Secure Roof Rights

When entering into a rooftop lease or licensing arrangement with a solar developer, the developer may require evidence that you have sufficient title and legal rights to grant separate control over the roof to the developer. The roof can’t be subject to existing liens, mortgages or other legal restrictions that impede you from granting the developer exclusive rights.

You may also need to obtain a subordination and nondisturbance agreement from your lender. Ensure that the developer obtains appropriate insurance coverage as well.

Anticipate Roof Maintenance

Roof-mounted solar installations generally last 35 to 40 years, but the lifespan of a commercial building roof is usually much shorter. If the roof has been leased or licensed to a solar developer, the revenue stream can dry up quickly if the agreement doesn’t address maintenance issues. The lease or licensing agreement should include provisions related to:

- Notice of repairs,
- Duration of work,
- Relocation of solar equipment during the work, and
- Compensation for the developer’s lost revenue during the repair or replacement work.

If the roof was repaired or replaced shortly before the installation of solar panels, pay careful attention to the terms of any applicable warranty. Solar panel installation activities could invalidate critical warranty provisions.

Do Your Research

Solar power is increasingly popular, with major companies like Costco, Kohl’s and Walmart all getting into the game. Before you jump on the bandwagon, however, research the concept carefully to determine how to best take advantage of the energy opportunities in your market.

IT ALL ADDS UP

Partner Profile: Vincent S. Barra, CPA

With more than 30 years of experience in accounting and tax matters specific to the real estate industry, Vincent S. Barra, CPA, assists his clients in navigating through numerous types of real estate transactions including, but not limited to, acquisitions, dispositions, debt restructurings and business entity formations. He is a member of both the American Institute of Certified Public Accountants (AICPA), as well as the New York State Society of CPAs, where he formerly served as Chairman of the Real Estate Committee. Vincent is based in Marks Paneth's midtown Manhattan headquarters.

THE TAX IMPLICATIONS OF C CORPORATION ACQUISTIONS

If you're in the market to acquire a C corporation, beware. There's much you need to know about the tax ramifications of holding such real estate in a C corporation. Here are some of the key concepts to keep in mind.

What you need to know

Owners of a C corporation that holds real estate may prefer to sell the corporation's stock rather than incur the double taxation that would be imposed if the real estate were sold and the proceeds were distributed to the stockholders. To facilitate a quick transaction, the owners might, therefore, offer a reduced price if you take on their corporate structure.

Potential purchasers, however, need to look beyond the price. They should carefully consider certain tax and other issues that wouldn't ordinarily arise in a traditional real estate acquisition.

As mentioned above, double taxation is one of the primary disadvantages of a C corporation. That is, the corporation's profits are first taxed at the corporate level. Then, if the corporation pays out some of its profits as dividends, the dividend recipients are also taxed. On the flip side, ongoing tax losses — which are common with real estate activities — can't be used to offset a shareholder's other income because the losses are inside the corporation.

It usually isn't advantageous to convert a C corporation to S corporation status, because of the taxes owners would face on built-in gains. Converting to a limited liability company could also have substantial negative tax consequences, because it would be treated as a liquidation.

How Basis Fits In

When you buy C corporation stock, your tax basis in the real estate owned by the corporation isn't impacted, as it would be if you had purchased the assets: there are no step-ups recorded which could

result in additional depreciation deductions. While your tax basis in your stock is equal to your purchase price, the depreciable assets inside the corporation continue to be depreciated as they were depreciated before your acquisition.

When Transfer Tax Affects a Deal

The cost of the deal could be affected by transfer taxes that commonly range from 0.1% to 5.0% of the real estate's value, depending on the location of the property. Some states and numerous municipalities impose a transfer tax on *indirect* transfers of ownership in real estate. They don't require the recording of a deed, change of name or bill of sale.

In such jurisdictions, the mere transfer of a "controlling interest" in a legal entity is considered a taxable transfer of real property. A controlling interest is usually defined as 50% or more of the ownership interests in the entity.

Two general approaches are taken for determining whether a transaction triggers the transfer tax. First, under the broad approach, the jurisdiction taxes any transfer of a controlling interest in an entity that owns real estate in the jurisdiction.

Under the more narrow approach, the jurisdiction taxes transfers of controlling interests only if the entity being transferred was primarily in the business of owning real estate (often determined by comparing its real estate activity with its total activities). It's the law of the jurisdiction where the real estate is located that applies, not the law of the jurisdiction of the C corporation's incorporation or of the purchaser.

But transfer taxes aren't the only thing you should be concerned about. You'll also need to keep in mind that the value of the real estate could be undermined by pre-existing legal liabilities, such as tax delinquencies-including income and payroll taxes, environmental issues, liens, and all other prior history of the corporation.

Rock Solid

If you're considering a C corporation acquisition, be sure to discuss the implications with your tax advisor before you get in deep on the deal. He or she can guide you through the process to help you avoid unpleasant surprises.

LEVERAGE OUR EXPERTISE

Marks Paneth LLP has served the real estate industry for more than 100 years. We assist many of the industry's premier commercial and residential real estate owners, developers, builders, REITs (real estate investment trusts) and property managers. With more than 100 professionals, including 15 partners and principals, who focus on the real estate industry, we bring deep expertise to every engagement.

For Further Information

If you have any questions, please contact William Jennings, Principal-in-Charge of the Real Estate Group, at 212.503.8958 or wjennings@markspaneth.com or any of the other partners in the Marks Paneth Real Estate Group.

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