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Profitable Ideas for Automobile Dealers

2016 Path Act Delivers Significant Tax Savings for Dealerships

Von Gammon
Principal
vgammon@vgncpa.com

If you are a real property owner, lessor, or lessee, or an advisor to such, you know that there are a myriad of property classifications which offer varying tax depreciation benefits that could create significant tax savings. The PATH Act of 2015 added another property classification which has the potential for significant depreciation benefits. However, before we get to this new category, let's review the steps in analyzing how to depreciate improvements to a building.

1. Determine who the tax owner of the property is with regard to leased property. Only the tax owner can claim depreciation deductions.
2. Review the nature of the improvements to determine if some or all would be eligible for expensing under the Repair Regulations.
3. Consider a cost segregation study to break out any Section 1245 assets eligible for shorter depreciation lives, generally five and seven years. Furthermore, a cost segregation study will also determine the amount of improvements eligible for the various real property categories discussed below.
4. Determine which capitalized real property improvements are eligible for the categories offering 15-year life, bonus depreciation and/or Section 179 expensing opportunities. (i.e. Qualified Property)

The qualified improvement categories that were available prior to 2016 included:
- Qualified Leasehold Improvement Property,
- Qualified Retail Improvement Property, or
- Qualified Restaurant Property.

Each of these has unique eligibility criteria and depreciation provisions, which were made permanent by the PATH Act, and should be analyzed carefully.

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The new category for 2016 is simply known as Qualified Improvement Property (QIP). It is defined as any improvement to an interior portion of a building that is nonresidential real property. A QIP includes a variety of changes or upgrades including improvements to electrical, plumbing or lighting, new drop ceiling or tile flooring to name just a few. This improvement must be placed in service after the date such building was first placed in service. It should be noted that, unlike the definition of Qualified Leasehold Improvement Property, QIP is not subject to a lease between nonrelated parties and there is no requirement that the building be greater than three years old. However, similar to Qualified Leasehold Improvement Property, QIP excludes the enlargement of the building, elevators, escalators and internal structural framework.

QIP is a newly-defined category that is eligible for bonus depreciation. However, it retains a 39-year recovery period. Therefore, generally it will still be more advantageous to first classify qualifying property as Qualified Leasehold Improvement Property, Qualified Retail Improvement Property, or Qualified Restaurant Property. Then remaining QIP that doesn't "fit" anywhere else, will have a 39-year recovery period but be eligible for bonus depreciation.

Below is an example of the potential tax benefit:

A business decides to undergo a renovation project of its facilities which are completed on June 30, 2016. After going through the four steps above, it is determined that $100,000 of the improvements are identified as QIP that are not classified as any other type of Qualified Property. Therefore, this property would be eligible for 50% bonus depreciation of $50,000 and 39-year MACRS depreciation of $700 on the remaining basis after bonus, for a total first year depreciation deduction of $50,700. In contrast, without this new classification of Qualified Property, all $100,000 would be subject to 39-year MACRS for a deduction of $1,400. At an effective tax rate of 40%, the additional first year deduction of $49,300 yields a tax savings of almost $20,000.

Therefore, any significant improvements in 2016 and beyond should be analyzed to determine if they are eligible for the new QIP classification.

Is your dealership planning to make any improvements? Contact any member of the team at Vawter, Gammon, Norris and Company, P.C. to see if your dealership qualifies for the new QIP classification.