

AN ALERT FROM THE BDO FEDERAL TAX PRACTICE

# BDO KNOWS:

## FEDERAL TAX



### SUBJECT

## IRS RELEASES REMODEL SAFE HARBOR FOR RESTAURANTS AND RETAILERS

### SUMMARY

On November 19, 2015, the Internal Revenue Service issued Revenue Procedure 2015-56, which provides certain retailers and restaurants a safe harbor method of accounting for remodel or refresh expenditures on qualified buildings. The safe harbor helps eliminate confusion around which costs may be deducted immediately and which must be capitalized and depreciated over time. The Revenue Procedure also provides instruction for obtaining automatic consent to convert to the safe harbor method of accounting.

Under the safe harbor, retailers and restaurants with applicable financial statements are able to take 75 percent of qualifying expenditures as an immediate deduction. The remaining 25 percent is capitalized and depreciated over time.

This revenue procedure is effective immediately for tax years beginning on or after January 1, 2014.

### DETAILS

#### *Definition of a Remodel-Refresh Project*

A remodel-refresh project is defined as a planned undertaking on a qualified building to alter its physical appearance and/or layout for one or more of the following purposes:

- ▶ To maintain a contemporary and attractive appearance
- ▶ To more efficiently locate retail or restaurant functions and products
- ▶ To conform to current retail or restaurant building standards and practices
- ▶ To standardize the consumer experience if a taxpayer operates more than one qualified building

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- ▶ To offer the most relevant and popular goods in the industry
- ▶ To address changes in demographics by altering product or service offerings and their presentations

A qualified building is one that is used primarily for selling merchandise at retail or for preparing and selling food or beverages to customers for sit-down or to-go consumption. Leased buildings will generally qualify.

### ***Qualifications and Exclusions***

To qualify for the safe harbor, a taxpayer must have an Applicable Financial Statement and conduct activities within NAICS codes 44, 45 or 722 with some specific exceptions such as gas stations, automotive dealers and caterers.

In general, a taxpayer may not take partial disposition losses and must also make a general asset account election for the applicable buildings.

Remodel-refresh costs are amounts paid for remodel, refresh, repair, maintenance or similar activities performed on a qualified building as part of a remodel-refresh project. Examples include:

- ▶ Painting, polishing or finishing interior walls
- ▶ Adding, replacing, repairing, maintaining or relocating permanent floor, ceiling or wall coverings or kitchen fixtures
- ▶ Adding, replacing or modifying signage or fixtures
- ▶ Relocating or changing the square footage of departments, eating areas, checkout areas, kitchen areas, beverage areas, management space or storage space within the existing footprint of a qualified building
- ▶ Moving, constructing or altering walls within the existing footprint of a building
- ▶ Adding, relocating, removing, replacing or re-lamping lighting fixtures
- ▶ Making non-structural changes to exterior facades
- ▶ Repairing, maintaining or replacing the roof or a portion of the roof within the existing footprint of a qualified building

Examples of excluded remodel-refresh costs include Section 1245 property, intangibles, land improvements and the initial build-out costs of a qualified building.

### ***Benefit***

The safe harbor method minimizes the need to perform a detailed factual analysis to determine whether each remodel-refresh cost is a repair or maintenance deduction or should be capitalized. The safe harbor allows 75 percent of qualified expenditures to be deducted and 25 percent to be capitalized.

### ***Automatic Change in Accounting Method***

The Revenue Procedure adds two new automatic change numbers:

1. Change number 221 - "Revocation of partial disposition election under the remodel-refresh safe harbor described in Rev. Proc. 2015-16"
2. Change number 222 - "Remodel-refresh safe harbor method"

## BDO INSIGHTS

- ▶ The Revenue Procedure is a welcome safe harbor to address unique remodel issues and challenges in the retail and restaurant industries.
- ▶ The safe harbor method reduces the need for taxpayers to spend significant resources to determine whether remodel costs should be deducted or capitalized.
- ▶ The Revenue Procedure provides a helpful appendix for documentation standards and computation of qualified costs. See pages 49-51 of [Revenue Procedure 2015-56](#).
- ▶ The eligibility for smaller retailers and restaurants will be limited by the Applicable Financial Statement requirement.

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