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Safe-Harbor Method for Restaurant and Retail Refresh/ Remodeling Costs

Dear clients, colleagues and friends,

The Internal Revenue Service recently released a Revenue Procedure that could have significant benefits to businesses that operate retail establishments or restaurants. It can also benefit taxpayers who lease property to certain businesses. This benefit is in the form of a “safe harbor” method that allows qualified taxpayers to immediately deduct 75 percent of their qualified refresh or remodel expenditures while only having to capitalize the remaining 25 percent.

If your business fits the “qualified taxpayer” description (defined below) and has recently or will soon undertake a planned remodel or refresh project, this safe harbor could be of great benefit.

Under this guidance, qualified **retail** or **restaurant** businesses that undertake a refresh or remodel project can forego the application of complex IRS rules to determine which costs to expense vs. capitalize. Instead, they can use this new safe harbor to simply expense 75 percent of the costs for an immediate tax deduction.

A qualified taxpayer that can take advantage of this safe harbor is one who has Applicable Financial Statements (generally audited financial statements) and that:

- 1. is in the trade or business of selling merchandise to customers at retail**, for which the taxpayer reports or conducts activities within NAICS codes 44 or 45 OR
- 2. is in the trade or business of preparing and selling meals, snacks or beverages to customer order for immediate on-premises and/or off-premises consumption**, for which the taxpayer reports or conducts activities within NAICS code 722 (with some exceptions) OR
- 3. owns, or leases, a qualified building** that is leased, or sublet, to a taxpayer that meets the requirements of (1) or (2) above and incurs remodel-refresh costs

A refresh/remodel project means a planned undertaking by a qualified taxpayer on a qualified building to alter its physical appearance and/or layout to maintain a contemporary and attractive appearance, to more efficiently locate retail or restaurant functions and products, to conform to current standards and practices, to standardize the consumer experience, to offer the most relevant and popular goods, or to address changes in demographics.

The safe harbor does not apply to certain costs, including:

- Personal property
- The initial build-out for a new lessee
- Material additions to a qualified building
- Adapting more than 20 percent of the total square footage to new or different uses
- Costs incurred during a temporary closing
- Expenditures treated as qualified lessee construction allowances

A qualified taxpayer that uses the new safe harbor must document and maintain a record of its qualified costs.

Background:

Refresh/remodel projects frequently involve work performed on building structures and a variety of building systems. The IRS rules generally require taxpayers performing such projects to apply separate legal analyses to many different components of the building. These analyses become especially difficult in situations where, as part of their remodel-refresh projects, taxpayers adapt portions of space to a new and different use. Moreover, the application of the improvement rules to particular buildings can be complex because remodel-refresh projects vary so much in frequency, quality, and degree. Consequently, taxpayers and IRS frequently encounter questions on whether the costs for a particular remodel-refresh project should be characterized as repairs, maintenance, or an improvement of the taxpayers' property, causing taxpayers and the IRS to expend significant resources on this factually intensive issue.

New Guidance:

Revenue Procedure 2015-56 provides a safe harbor approach under which qualified taxpayers may determine the part of their remodel-refresh costs that may be deducted or must be capitalized. The safe harbor method minimizes the need to perform a detailed factual analysis to determine whether each remodel-refresh cost incurred during a remodel-refresh project is for repair and maintenance or for an improvement. Because the safe harbor method is applied to the entire building unit of property, the safe harbor method also eliminates the need to apply these rules separately to each building structure and each building system. The safe harbor also eases the factual inquiry into whether costs incurred during a remodel-refresh project adapt property to a new or different use, requiring qualified taxpayers to exclude from the safe harbor only amounts that adapt more than 20 percent of the total square footage of the building to a new or different use.

Please contact your Green Hasson Janks tax advisor or Tax Principal Daniel Rowe (drowe@greenhassonjanks.com) for additional information or to determine whether this development relates to your business.

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