Celebrating Ten Years of Exceptional Service

NEWS YOU CAN USE FROM WTAS

for the RECORD

July 2012

IN THIS ISSUE

Donate Everything... Including the Kitchen Sink!
page 1 »

Voluntary Corrections to Section 409A Nonqualified Deferred Compensation Plans
page 3 »

Help! The IRS is Auditing Me!
page 5 »

Creating and Evaluating Investment Success
page 6 »

Failure to Properly Substantiate Charitable Contributions
page 8 »

To Capitalize or Not To Capitalize – Regulations Under Repairs
page 10 »

Donate Everything...Including the Kitchen Sink!

Are you considering demolishing your home and rebuilding on the property, or buying property with the intention of demolishing the existing structure?

Contractors and taxpayers are recognizing that while one man's trash may be another man's treasure, it can also be a charitable deduction. The trend towards environmental friendliness has gone from installing eco-friendly, energy-efficient home heating and cooling systems to recycling and reusing nearly an entire home.

Although a taxpayer may want to demolish an existing home on the property, it may hold many items that could be recycled and reused by another consumer. There are several charitable organizations across the country that will accept new or gently-used materials from a home such as cabinets, appliances, doors, light fixtures, siding, roofing, windows, flooring, etc. The traditional demolition process does not afford the removal of these materials from the home without being damaged. However, a deconstruction of the home may be the perfect solution to this problem.

Demolition vs. Deconstruction

Demolition uses heavy machinery to knock down and completely destroy a home. The materials are condensed and transported to a landfill.

Deconstruction is the careful removal, using hand tools, of salvageable building materials from a home on a room-by-room basis. All usable materials are sorted and distributed for donation and reuse. The remaining structure is then demolished using conventional demolition methods.

CONTRIBUTORS

Marilyn Calister
Luke Coombs
Trevor Hancock
Debra Hanrahan
Sid Luckenbach
Dennis Minich
JC Rice
Eleni Sakkos
Lee Sussman
Brian Ullsperger

What are the Benefits of Opting to Deconstruct?

Numerous charitable organizations that focus on building homes and living facilities in low-income or disaster areas gladly accept the donation of new or gently-used materials in furtherance of their charitable purposes. From the donor's perspective, tax savings received from the charitable deduction will help a taxpayer recover some of the out-of-pocket cost to demolish the home despite adding additional cost to deconstruct the home for reusable materials. Since deconstruction employs environmentally-friendly methods to remove an unwanted structure, more manual labor is required and thus, it is a more expensive option. However, the reusable materials are diverted from landfills (thus providing a "green" solution) and the charitable organization will receive new inventory for direct use in homes or to put up for sale. It's a win-win situation. There are also construction companies that will move an entire home to a new location for use by a charity or third party.

How Can Taxpayers Receive a Charitable Deduction?

A few important steps must be completed to ensure that the donating taxpayer receives a charitable deduction.

1. Identify a qualified deconstruction contractor for an estimate of demolition and deconstruction costs and to determine a charitable organization that accepts reusable materials from the home.
2. Retain a certified appraiser to inspect the property and to take measurements and photographs to determine the materials in the home that are eligible for donation. The appraiser will give the taxpayer an estimate of the charitable donation per square foot of living space. This will vary based on the location, age, style and condition of the home. The deconstruction contractor should be able to assist with identifying an independent appraiser.
3. Perform a cost-benefit analysis to determine the economic advantage of "going green."
4. At this point, the deconstruction can begin and an inventory of reusable materials prepared for donation to the recipient charitable organization.
5. The taxpayer will receive the appraisal for the donated materials along with Form 8283, *Non-Cash Charitable Contributions*. This form must be signed by the appraiser and a representative from the charitable organization. The taxpayer is required to attach both Form 8283 and the appraisal to the tax return as support for the charitable deduction.

Economic Benefit Analysis

The following chart illustrates the possible after-tax benefit of using the deconstruction method over the traditional demolition method for the complete removal of a 6,000 square foot home with 5,000 square foot of living space. The cost of demolition is treated as a fixed cost to the taxpayer since it will be incurred regardless of whether the taxpayer proceeds with the recycling of the useable materials. The cost of hiring a deconstruction company and the appraisal fee for the donated property value are the added costs by which the taxpayer will compare the benefit of receiving a charitable deduction.

	Deconstruction Method	Traditional Demolition Method
Cost of Demolition (Fixed Cost)	$ 45,000	$ 45,000
Additional Cost for Deconstruction	$ 15,000	$ 0
Appraisal Fee for Donated Property Value	$ 2,500	$ 0
Total Costs	**$ 62,500**	**$ 45,000**
Appraised Charitable Contribution (based upon appraiser's estimate and the condition of salvaged materials) Total assumed charitable contribution using $35 per square foot (assumed 5,000 square foot of living space)	$ 175,000	$ 0
Cash Value @ 40% (combined federal & state tax rates)	$ 70,000	$ 0
Total Costs (From Above)	$ 62,500	$ 45,000
Total After-Tax Benefit/(Cost)	**$ 7,500**	**($ 45,000)**

As illustrated in the analysis above, an additional $17,500 of out-of-pocket costs to use the deconstruction method results in after-tax savings of approximately $7,500. In addition to tax savings, there are environmental and positive perception benefits in one's community by using the deconstruction method that cannot be quantified in this analysis.

One should be sure to consider the tax saving options before knocking down the house and realizing the opportunity went down the drain. Given the broad range of benefits associated with choosing the deconstruction process, it will undoubtedly continue to be a growing area of interest as real estate markets improve. ■

Voluntary Corrections to Section 409A Nonqualified Deferred Compensation Plans

It has been almost eight years since the enactment of Section 409A, setting forth the complex rules governing the timing, form and tax treatment of nonqualified deferred compensation payments.

The final regulations under Section 409A were effective January 1, 2009, at which time non-grandfathered deferred compensation plans had to be updated to comply with the rules. Operationally, nonqualified deferred compensation plans have had to comply with the published guidance since January 1, 2005.

Service recipients (for purposes of this article, service recipient will be referred to as employer) that maintain nonqualified deferred compensation arrangements may want to review their documents and procedures for any Section 409A compliance violations. IRS has provided voluntary compliance programs for employers to use to correct document failures (Notice 2010-6, 2010-3 IRB 275) and operational failures (Notice 2008-113, 2008-51 IRB 1305). Corrections made pursuant to these Notices are done without IRS approval. If employers self-correct violations prior to an IRS audit, the sanctions may be significantly reduced.

The following is a brief overview of the compliance programs available to employers to correct plan document and operational failures.

Correction of Plan Document Failures

IRS issued Notice 2010-6 to provide employers with the opportunity to review their plan documents and voluntarily correct many types of failures to comply with the document requirements under Section 409A.

If employers self-correct violations prior to an IRS audit, the sanctions may be significantly reduced.

In general, to take advantage of Notice 2010-6, the service provider (for purposes of this article, service provider will be referred to as employee) and the employer may not be under examination with respect to nonqualified deferred compensation for any taxable year in which the document failure existed. In addition, the employer must take commercially reasonable steps to identify all nonqualified deferred compensation plans that have

substantially similar inadvertent and unintentional document failures and correct all such failures in a manner consistent with Notice 2010-6. In addition, the failures may not be related, directly or indirectly, to participation in any listed transaction, i.e., one of a group of tax-oriented transactions identified as abusive by IRS.

Notice 2010-6 provides:

1. Clarification that certain language commonly used in plan documents will not cause a document failure. The use of "as soon as reasonably practicable" for the timing of a payment after a permissible payment event or the use of "termination of employment" or "acquisition" as payment events will not result in a violation as long as the payment is made in compliance with the Section 409A payment requirements.
2. Relief by permitting employers to correct certain document failures without current income inclusion to the employee or the additional taxes under Section 409A, provided that the corrected plan provision does not affect the operation of the plan within one year following the date of the correction.
3. If the corrected plan provision does affect the operation of the plan within one year of the date of correction, then relief is available by limiting the amount currently includible in the employee's income and the additional taxes under Section 409A.
4. If the plan is a new type of deferred compensation plan sponsored by the employer, then corrections can be made by the end of the calendar year in which, or the 15th day of the third calendar month following, the date the first legally binding right to deferred compensation arose under the plan.

Besides making the appropriate corrections and, if applicable, reporting income to the employee, the employer must attach a statement (explaining the failure) to its timely-filed (including extensions) original federal income tax return for its taxable year in which the correction is made, as well as in the taxable year in which the employee includes any amount in income. This statement is also required to be provided to the impacted employees. Depending on the correction, each employee impacted by the amendment must attach a copy of the statement received from the employer to his or her income tax return.

Correction of Operations Failures

Under Notice 2008-118 (as modified by Notice 2010-6 and Notice 2010-80, 2010-51 IRB), employers can obtain relief from the full application of the income inclusion and the additional taxes for employees under Section 409A with respect to certain failures of a nonqualified deferred compensation plan to comply in its operation with Section 409A.

To be eligible for relief under Notice 2008-113, the employer must take commercially reasonable steps to avoid a recurrence of the operational failure. Relief is not available if the employee's federal income tax return for the year in which the operational failure occurs is under examination with respect to the plan. The employee is required to repay the employer the amount erroneously paid or made available to the employee. Finally, relief is not available with respect to any erroneous payment occurring during any taxable year of the employee in which the employer experiences a substantial financial downturn.

The only corrections permitted under Notice 2008-113 include: (1) the failure to defer an amount or the incorrect payment of an amount payable in a subsequent taxable year; (2) the incorrect payment of an amount that is payable in the same taxable year or the incorrect payment to a specified employee; (3) excess deferral of compensation in the same taxable year; and (4) the correction of the exercise price of a stock right otherwise excluded from the definition of nonqualified deferred compensation. The permitted corrections fall within one of the following:

1. Correction of operational failures in the same taxable year as the failure occurs;
2. Correction of certain operational failures involving non-insider (a director, officer or 10% owner of the employer) in the immediately following taxable year in which the failure occurs;
3. Correction of certain failures involving limited amounts; or
4. Correction of certain other operational failures that are not otherwise covered by the Notice that are correct by the last day of the employee's second taxable year following the year in which the failure occurred.

The employer must attach a statement to its timely-filed original federal income tax return for its taxable year in which the failure occurred. The statement needs to include, among other things: (1) names of the impacted employees; (2) description of the failure and how it occurred; (3) description of steps taken to correct the failure; and (4) a statement that the employer is eligible for the correction program. In addition, the employer must provide similar information to the employee no later than the date, including extensions, on which the employer is required to provide to the employee an information return (Form W-2 or Form 1099) for the calendar year in which the error occurred. ■

Help! The IRS is Auditing Me!

The May 2012 issue of WTAS' For the Record described a number of CP Notices that taxpayers receive.

That article discussed these computer generated notices and what taxpayers should do if they receive one in the mail. This article will focus on the audit process. Audits do vary in scope but clearly, the more complex the taxpayer's return, the higher probability of audit.

The most common type of audit is a "desk" audit. This is also sometimes referred to as a "correspondence" audit. In these audits, Internal Revenue Service (IRS) simply sends a notice of audit to the taxpayer along with an Information Document Request (IDR). The taxpayer (or representative) then compiles the requested information and remits it to the assigned agent. In many cases, the agent does not request a face-to-face meeting, but rather completes their review of the information and provides the taxpayer with a Revenue Agent Report (RAR) depicting their proposed adjustments. Historically the correspondence audit has focused on one or two items of income-deduction. Recently, however, we have seen very detailed IDRs as part of correspondence audits requiring much more communication (phone and correspondence) with the agent to resolve.

The most common type of audit is a "desk" audit. This is also sometimes referred to as a "correspondence" audit. In these audits, Internal Revenue Service (IRS) simply sends a notice of audit to the taxpayer along with an Information Document Request (IDR).

This first level of IRS review is known as the "collections" stage. This phase will entail one or more IDRs that allow IRS to gather relevant information regarding specific items or forms reported/included in the return. After all information deemed necessary by IRS has been gathered and reviewed, the agent will informally communicate the findings to the taxpayer where he or she may debate the findings or appeal to the IRS agent's supervi-

sor. If this fails to alter any adverse findings, the IRS agent will provide the taxpayer with a Form 4549-A, *Income Tax Discrepancy Report*, that details all proposed changes and calculates the tax due. Generally this form is accompanied by Form 886-A, *Explanation of Adjustments*, which provides the analysis of the changes and IRS Letter 525, *General 30 day Letter*. At this point the taxpayer can either agree to IRS' findings and pay the tax liability or formally protest the adjustments within the 30-day period. IRS can extend the 30-day period and the extension is generally determined by the complexity of the case. The protest will include a detailed analysis of the taxpayer's position on the disagreed adjustments. Once the taxpayer protests the adjustments, the case will move to IRS' Appeals Division.

The appeals process is designed to resolve specific areas of disagreement as opposed to revisiting a case in its entirety. The Appeals Division will work through the differences and has the authority to settle the case as it deems appropriate. As opposed to the IDRs at the collections stage, which request substantive information like bank records or cancelled checks, the Appeals Division reviews the legal basis upon which the taxpayer disagrees with IRS. If the case is not settled at appeals, the taxpayer can request further dispute resolution procedures. The options available at this point are post-appeals mediation, arbitration and petition to the U.S. Tax Court.

Arbitration is not designed to resolve disputes involving legal arguments, but instead to focus on resolving factual disputes, for instance, the value of an item for gift tax purposes.

Post appeals mediation involves the selection of mediators (taxpayer's and IRS') who will review the legal analysis and hear arguments from both IRS and the taxpayer. The goal is to broker a settlement between the parties by first assessing the strength of the various arguments (litigation risk) and then attempting to bring the parties to a settlement. Note that contrary to the name of the process, the taxpayer's case is still in appeals. The mediation occurs prior to appeals rendering an official decision through the issuance of a Statutory Notice of Deficiency (Letter 531). If the taxpayer chooses to request mediation, he/she does not give up any rights to subsequently petition the U.S. Tax Court or Federal District Court.

Another dispute resolution mechanism is binding arbitration. This procedure is generally available when there are a limited number of factual issues that remain unresolved following settlement discussions in the appeals process. Arbitration is not designed to resolve disputes involving legal arguments, but instead to focus on resolving factual disputes; for instance, the value of an item for gift tax purposes. Arbitration involves the taxpayer and appeals presenting their arguments to an arbitrator (independent third party) who renders a decision based on the information presented. Binding arbitration will yield a final decision that cannot be appealed to U.S. Tax Court or Federal District Court.

If an agreement cannot be reached within appeals, a Statutory Notice of Deficiency will be issued. The taxpayer may:

- Accept IRS determination and pay the tax;
- Petition the Tax Court within 90 days; or
- Pay the tax and file suit in the U.S. District Court to obtain a refund.

If the taxpayer does not prevail at the Tax Court or District Court level, the case can be appealed to the U.S. Court of Appeals, and ultimately the Supreme Court of the United States.

The IRS audit process can be relatively painless or fairly painful depending upon the complexities of a taxpayer's return. However, it is important to know that there are many avenues available to help a taxpayer resolve these issues. Also, because dealing with the various aspects of an audit can be complicated, it is important to obtain professional assistance with the process. There are pitfalls to avoid and opportunities to be aware of. A knowledgeable tax professional can walk you through this maze while hopefully bringing your audit to a favorable conclusion. ■

Creating and Evaluating Investment Success

Each year, financial journalists and bloggers write countless articles for their respective reputable newspapers and financial magazines about theories of how one might "beat the S&P" or "outsmart the markets."

Yet despite what these so-called prognosticators would have you believe, financial advisors do not possess crystal balls to consistently beat the markets. Chasing hot stocks and timing the market often lead to disappointing results. Instead, investors should develop strategic investment plans, avoid the common investing mistakes, and most importantly, establish a personal benchmark—or required return—that aligns with their unique goals and

objectives. A comprehensive approach to wealth management should involve an investment strategy that integrates tax and estate planning with appropriate investment consulting wherein a financial advisor measures the ultimate success of that strategy by its ability to achieve specific investor goals and objectives.

Moving toward a more comprehensive, goal-oriented practice of wealth management and financial advising requires an improved metric for assessing an investor's tolerance for risk. Traditional risk profiling does not incorporate goals, the dollars required to meet them, or the time horizon. Instead of addressing the investor's specific objectives or needs, the discussion of what might constitute an appropriate portfolio is framed solely in terms of "risk." More often than not, this method of risk profiling simply encourages the investor to position his or her portfolio at the highest level of risk that he or she can stomach. During the economic downturn of 2008, this type of portfolio construction put many investors in a position where they took on too much risk. Because of this, many of these investors bailed on their strategy and missed the market recovery in 2009. This was a costly, yet all too common, mistake.

Another common mistake is the tendency of investors to adopt the "herd mentality," that is allowing current market conditions and emotions to dictate allocation and investment decisions. In short, a bull market can tend to make an investor aggressive (chasing returns) and a bear market can increase caution and apprehension (buy high, sell low). Investors often make portfolio decisions such as these irrespective of their goals, needs and time horizons. Emotional decision-making can have disastrous effects. The herd mentality exhibited in October 2007—the height of a bull market— led many investors to allocate large portions of their portfolio into equities simply because the market was doing well and, emotionally, it seemed to make sense to do so.

So how might an investor establish a required return and avoid some of these common mistakes? First, an investor must understand the limits of what can be controlled. No matter how much we would all like to control or consistently predict the direction of the market (and despite the fact that many claim to be able to), the unfortunate but liberating truth is that we cannot. Therefore, understanding and accepting what one can and cannot control will help ensure that investing efforts are properly aligned with goals. Focus on controlling the following:

Moving toward a more comprehensive, goal-oriented practice of wealth management and financial advising requires an improved metric for assessing a client's tolerance for risk.

Risk: Modern portfolio theory suggests that risk can be controlled through asset allocation. We define asset allocation as investing both across and within asset classes and styles. Historically, over short periods of time, stocks are more risky (volatile) than bonds and bonds are more risky than cash. Over longer periods, investors can be rewarded for taking additional risk.

Costs: Investors should seek out value, not just the cheapest investment or strategy. Expensive strategies should be evaluated frequently to ensure that their costs are justified.

Taxes: If investment managers do everything right, investors will pay taxes. However, investors should be tax aware and efficient where possible.

Second, an investor must develop a plan based on his or her unique goals and objectives. Investors should create their own personal benchmark or required rate of return that will provide guidelines to help them achieve those ambitions. This personal benchmark can and should be used to measure success. How?

Goals: What do you want and need your money to do for you? What is most important?

Quantifiable Dollar Amounts: How much will you need to achieve your goals?

Time Horizon: What are your timelines or deadlines to achieve your goals?

After addressing these questions, investors should be able to synthesize both a required rate of return and an asset allocation policy designed to achieve that return. As a byproduct, this will position the portfolio at the lowest level of risk necessary, an inverse approach to that which would position the investor at the maximum level of risk that he or she can stomach. While this approach may not always produce outsized returns, it should help avoid outsized losses. Periodically, investors should reassess their goals, review the quality of their investments and rebalance when appropriate.

An objective and trusted advisor should help one develop and implement a plan as well as assist in keeping the plan in line with goals to ensure a high probability of success. As the last few years have shown, sometimes the most inscrutable strategies and investments are not the most appropriate, only the most complicated. Wealth is built over time with patience, discipline and consistency. ■

Failure to Properly Substantiate Charitable Contributions

Most taxpayers are familiar with the benefit of charitable contribution deductions.

When a donation is made to a qualified charity, the gift can be claimed as a tax deduction, as governed by Section 170 of the Internal Revenue Code (and related Regulations) and, thereby, can reduce overall taxable income. However, recent tax rulings have suggested that although taxpayers recognize the significant savings that deductions can offer, they may not be aware of the specific steps that need to be taken in order to comply with Internal Revenue Service (IRS) substantiation requirements and qualify for a deduction on their non-cash contributions.

These recent cases can serve as a reminder that when making non-cash charitable contributions in an amount greater than $5,000, it is vital to obtain a qualified appraisal to meet the requirements to claim a tax deduction and submit the appraisal as part of the tax return.

Recent Tax Rulings

In *Mohamed v. Commissioner*, a California couple was penalized and denied an $18.5 million deduction for their real estate donations simply because they did not have the appropriate paperwork when they filed their return. IRS denied the deduction because the Mohameds did not have their contribution independently valued by a qualified appraiser, as required by tax law for non-cash property contributions of more than $5,000. Instead, the taxpayers prepared and filed their own tax return, including Form 8283, the form used to report non-cash contributions to charity. Despite the Mohameds' good faith, the Tax Court agreed that the Mohameds failed to meet the Section 170 requirements, upholding IRS' denial of the deduction. In other words, the Mohameds were denied their $18.5 million deduction for not reading the fine print and appropriately following instructions.

In *Rothman et al. v. Commissioner*, the Tax Court faced another non-cash donation involving a historic façade easement. There was no question that the easement was placed on the property and then donated to a qualified charity. Why, then, did

IRS deny the deduction? The appraisal did not meet the technical requirements of a qualified appraisal. In its detailed opinion, the Tax Court agreed with IRS that this appraisal failed on a number of the detailed qualified appraisal provisions of the regulations.

Do It Right

These recent cases can serve as a reminder that when making non-cash charitable contributions in an amount greater than $5,000, it is vital to obtain a qualified appraisal to meet the requirements to claim a tax deduction and submit the appraisal as part of the tax return. A qualified appraisal, as defined in the regulations, must include certain information including a legal description of the property, the property's physical condition, the date of the contribution and a statement that the appraisal was prepared for income tax purposes. The document must also describe the method(s) of valuation used to develop the value and the market data considered, among other items. The qualified appraisal must also be prepared by a qualified appraiser.

What is a qualified appraiser? A qualified appraiser, also defined in the regulations, is an individual who has earned an appraisal designation from a recognized professional appraisal organization, or has met the minimum education and experience in valuing the type of property being valued as outlined by IRS.

A qualified appraiser, also defined in the regulations, is an individual who has earned an appraisal designation from a recognized profession appraisal organization, or has met the minimum education and experience in valuing the type of property being valued as outlined by IRS.

As evidenced by the two cases above and numerous others, it is critical to get a qualified appraisal from a qualified appraiser to properly support a charitable deduction. Although the taxpayers in the aforementioned cases argued that their compliance with the rules was close enough, IRS and the Tax Court disagreed. The lesson seems clear: the tax law is complex. If the regulations list requirements one must follow to get a deduction, it is much easier to follow the steps from the start than try to challenge the validity of a regulation later. ■

To Capitalize or Not To Capitalize – Regulations Under Repairs

In December 2011, Internal Revenue Service (IRS) issued proposed and temporary regulations on the deduction and capitalization of expenses related to the repair, improvement, replacement, disposal and acquisition of tangible property.

These regulations impact both businesses and individuals. Individuals who own rental property or private jets, and businesses engaged in manufacturing, wholesale or retail activities, may be particularly concerned with the changes. The regulations, effective for 2012, will likely require proactive planning to identify the most favorable available treatments and to take the necessary steps to comply with the new rules. Application of the regulations may require special elections, internal documentation or submissions to IRS, all of which have due dates that must be met. This article provides a general overview of several of the key changes. Detailed discussions of complex areas, such as the impact on rental property, will be provided in future articles.

Improvements

Under the old regulations and case law interpreting those regulations, amounts paid to improve a unit of property were generally required to be capitalized. In the case of a building, the unit of property was generally considered to be the building and its structural components as a whole. Additionally, taxpayers were required to continue to depreciate a structural component which may have in fact been removed and replaced as part of the improvement. As a consequence, the taxpayer could have been in the position of simultaneously depreciating multiple roofs or HVAC units because of periodic replacements over the 39-year depreciable life of the building.

Under the new regulations, a unit of property is still defined as a building and its structural components. However, the improvement is not viewed in light of the unit of property as a whole, but the effects of the expenditure on the building structure and specifically enumerated building systems and their components. Such building systems include, among others, HVAC, plumbing systems, electrical systems, elevators and security systems. Because the building is now carved into smaller units for purposes of judging whether a particular expenditure improves the asset, the

new regulations arguably make it less likely a particular expenditure will be deductible for tax purposes. On the other hand, the new regulations allow taxpayers to elect to dispose of the component that has been replaced and therefore, claim a deduction that was not previously permitted.

Whether these new regulations help or hurt a particular taxpayer, however, depends on the taxpayer's previous method of accounting. Analysis is necessary to judge the impact of the regulations in any particular taxpayer's situation. Taxpayers that previously had repair studies performed under case law interpreting in earlier versions of the regulations may find that the new regulations are detrimental. Taxpayers that simply followed book reporting or utilized a policy of capitalizing all expenditures over a particular dollar amount may, by contrast, find the rules beneficial. Regardless of whether an earlier repairs study had been performed, the new regulations provide an electing taxpayer the opportunity to recognize a loss upon the retirement of a building component such as an HVAC unit, rather than continue to depreciate the retired unit as well as the replacement unit.

Specific to private jets, the new regulations were fairly consistent with the prior rules. Opportunities may exist to deduct the expenses of costly inspections and overhauls, such as engine maintenance and heavy maintenance on a plane's airframe that do not involve the replacement of major components or substantial structural parts.

General Asset Account Election

In general, under the old regulations, no loss is recognized upon the disposition of a component of an asset. Under the new regulations, the taxpayer may choose to claim a loss on a retired component of an asset for which the taxpayer has made a general asset account election. The new regulations permit the taxpayer to make a general asset account election for all assets in its fixed asset ledger as of its taxable year that begins in 2012. This election is beneficial because it gives the electing taxpayer a choice as to how it will treat the disposition of any particular component. The benefit of disposition treatment will vary depending on whether it relates to a major or minor component and whether the replacement is capitalizable or deductible under the regulations. Additional guidance on procedures for making this election is expected from the government.

Making the general asset account election for all potentially affected assets is anticipated to be advantageous for most taxpayers. The election permits flexibility with respect to both the treatment of retired components and the deductibility of repairs related to the retired components. Whether making the general asset election is appropriate in any particular situation for all assets in service in 2012 will depend upon the prospective tax savings, the cost of implementing the change and the documentation available.

Materials and Supplies

The definition and proper treatment of materials and supplies has been a recurring question addressed by various judicial and administrative authorities over the years. In 2008, proposed regulations defined materials and supplies as:

- Tangible property that generally is not a unit of property or acquired as part of a unit of property;
- If acquired as part of a unit of property, the economic useful life is either 12 months or less; or
- The property was acquired or produced for under $100.

The new regulations follow a similar framework, but modify the definition of materials and supplies by expanding the unit of property standard and providing a new category of materials and supplies for fuels, water, or lubricants consumed in 12 months or less. Additionally, the temporary regulations provide an optional method of accounting for rotable and temporary spare parts, an election to expense materials and supplies under an alternative de minimis rule, and an election to capitalize certain materials and supplies.

The alternative de minimis rule allows the taxpayer to elect to deduct the cost of materials or supplies over the $100 amount at the time the cost is incurred, instead of when the materials are used or consumed, so long as other administrative requirements and limitations are adhered to. The proposed regulations give the example of a company that provides consulting services to its customers. The company purchases 50 customized briefcases for its employees that have a useful life of less than 12 months and cost $120 each, and 50 office chairs for $80 each. The example assumes that the company meets the applicable administrative requirements and other cost limitations; thus, the company can elect to deduct the expense of the new briefcases and chairs in the year they are purchased. If the election is not made, the briefcases and chairs would be deductible in the year they are consumed.

Conclusion

The above discussion only begins to scratch the surface of the new regulations. Taxpayers should consult with their tax advisor on the applicability of these and other provisions in the regulations. While there is some latitude in the timing of required elections, taxpayers are well-advised to take a proactive approach to addressing the new regulations, including collaboration and consultation with their tax advisors for assistance in navigating the uncertainties in the regulations and evaluating all available options. ■

WTAS is one of the largest independent tax firms in the United States, providing a wide range of tax, valuation, financial advisory and related consulting services to individual and corporate clients across the country. The firm is comprised of over 500 personnel located in 14 major cities and encompasses top advisors with previous experience in the international accounting firms, law firms, the IRS and state taxing authorities. Our advisors hold multiple professional credentials and have depth in a wide range of capabilities allowing us to provide clients with comprehensive, integrated solutions.

WTAS Offices & Office Managing Directors

Chief Executive Officer
Mark Vorsatz
(415) 764-2784

Chicago, IL
Joseph P. Karczewski
(312) 357-3950

Madison, NJ
George T. Lyons
(973) 210-7062

Palo Alto, CA
J. Martin O'Malley
(650) 289-5700

Seattle, WA
Susan Swartz
(206) 577-7880

Baltimore, MD
David Bradt
(443) 539-8000

Greenwich, CT
Daniel G. DePaoli
(203) 987-3660

Los Angeles, CA
Kurt Brune
(213) 593-2300

Philadelphia, PA
George T. Lyons
(215) 654-1600

Washington, D.C.
David Bradt
(571) 382-0020

Boston, MA
Joseph Comeau
(617) 292-8400

Harrisburg, PA
George T. Lyons
(973) 210-7062

New York, NY
Joseph P. Toce, Jr.
(646) 213-5100

San Francisco, CA
Frank R. Cassidy
(415) 764-2700

West Palm Beach, FL
Michael Kohner
(561) 805-6550

Managing Directors

Abbin, Byrle – Washington, D.C.
Ackel, Rick – San Francisco, CA
Alberga, Lilli I. – San Francisco, CA
Amon, William J. – Los Angeles, CA
Amster, Susan K. – Los Angeles, CA
Anderson, Eric – San Francisco, CA
Anderson, Pat – Washington, D.C.
Ankrah, Sonny – Philadelphia, PA
Avigdor, Efrat - New York, NY
Bernard, Andrew – Philadelphia, PA
Blair, David – San Francisco, CA
Bonito, Ellen - New York, NY
Booth, Jeremy – New York, NY
Bradt, David — Washington, D.C.
Broderick, Tom – San Francisco, CA
Brune, Kurt — Los Angeles, CA
Burns, Kevin – Chicago, IL
Calister, Marilyn B. – New York, NY
Cassidy, Frank R. – San Francisco, CA
Castagne, Matthew - New York, NY
Chan, Nancy – Los Angeles, CA
Chubb, Charles M. – Philadelphia, PA
Cole, Dick – Los Angeles, CA
Comeau, Joseph — Boston, MA
Coombs, Luke – Baltimore, MD
Corrick, Stephen R. – Washington, D.C.
Coscia, Peter – New York, NY
Culhane, Edward – Boston, MA
Dannemiller, Jason – Seattle, WA
DeGirolamo, Joseph A. – San Francisco, CA
DePaoli, Daniel G. – Greenwich, CT
DesRoches, Gerald D. – New York, NY
Dondero, Jim - Boston, MA
Epstein, Armand – Boston, MA
Farro, John - New York, NY
Feria, Dean – West Palm Beach, FL
Fiore, Carl C. – New York, NY
Freda, Raymond – New York, NY
Freeman, David – Chicago, IL
Girard, Matthew – Philadelphia, PA
Goode, Jim – Boston, MA
Graham, Jason C. – San Francisco, CA
Guidice, Steven – New York, NY
Handa, Kurtis – San Francisco, CA
Hernandez, Sandra Y. – Los Angeles, CA
Hough, Michael – Boston, MA
Iwicki, Catherine – Seattle, WA
Jahn, Richard – New York, NY
Karczewski, Joseph P. — Chicago, IL
Kies, Bob – Los Angeles, CA
Kluemper, Joseph R. – New York, NY
Kohner, Michael — West Palm Beach, FL
Kyriacou, Andrew – Boston, MA
Lamprecht, Lance – Seattle, WA
Loer, Petra – San Francisco, CA
Lopez, Daniel – Los Angeles, CA
Love, Deana – West Palm Beach, FL
Luckenbach, Sid – San Francisco, CA
Lyons, George T. – Madison, NJ
Macpherson, Randolph – West Palm Beach, FL
McDonnell, Thomas R. – Philadelphia, PA
McGee, Debbie S. – Los Angeles, CA
Minich, Dennis – Chicago, IL
Morisky, Richard – San Francisco, CA
Mullen, John H. – San Francisco, CA
Nager, Ross – Houston, TX
Numair, Susan B. – San Francisco, CA
O'Malley, J. Martin — Palo Alto, CA
Pace, William M. – Los Angeles, CA
Peng, Janet – New York, NY
Pepin, Dorice – Chicago, IL
Percella, Angela – New York, NY
Pike, Ralph – Chicago, IL
Prifti, Robert – Boston, MA
Raaf, Jim – Chicago, IL
Rice, Chris – Seattle, WA
Roberts, David – New York, NY
Ruecker, Norman H. – San Francisco, CA
Schneidman, Len – Boston, MA
Seery, Brian – Los Angeles, CA
Shepard, Yichen – San Francisco, CA
Skrip, Martin J. – San Francisco, CA
Spiegelman, Chris – Greenwich, CT
Steinberger, Adam – Palo Alto, CA
Stroup, Keegan F. – Washington, D.C.
Swartz, Susan — Seattle, WA
Tauber, James – Chicago, IL
Thomas, Scott – Boston, MA
Thornson, Raymond L. – San Francisco, CA
Tillett, Monica – Washington, D.C.
Toce, Joseph P. Jr. — New York, NY
Ullsperger, Brian – Washington, D.C.
Ventress, Michelle – Chicago, IL
Vorsatz, Mark – San Francisco, CA
Weicher, Michael – New York, NY
Wilcox, Ron – Los Angeles, CA
Zemsky, Kenneth T. – New York, NY