

**Author: Scott Zickefoose, CPA**

*Article 2 of our 4 part series*

In Article 1 (Capitalization Rules: Building Systems), we discussed capitalization policies of real property as they relate to building systems. In this article, we focus on the clarifications as they relate to acquisition of real property.

The new temporary regulations did not offer much change as it relates to the acquisition of real property. Instead, the new temporary regulations offered more clarification for taxpayers. In general, the new regulations require that all costs that facilitate the acquisition or production of real property must be capitalized, with a few exceptions. We will discuss three groups of costs: investigatory, facilitative, and those incurred before placing a building in service. The temporary regulations specifically exclude internal costs such as employee compensation and overhead allocations from capitalization.

Investigatory expenses are expenses that a taxpayer incurs in the earliest stage of acquisition. These types of expenses are typically related to determining whether to buy real property or which real property to acquire. These costs, referred to as “whether or which” expenses in the temporary regulations, are eligible to be expensed as long as they are not inherently facilitative costs.

Facilitative costs are required to be capitalized. Reg. § 1.263(a)-2T(f)(2)(ii) specifically designates the following costs as “inherently facilitative”:

- › Shipping, moving or appraising property
- › Application fees
- › Sales and transfer taxes
- › Finder’s fees
- › Architectural, engineering, environmental or inspection services related to specific properties
- › Brokers’ or appraisers’ fees
- › Services provided by a qualified intermediary

The temporary regulations offer an example of a retailer that hires a consultant to determine the best location for his or her new store. Once the consultant has suggested a location, the retailer pays an appraiser to determine the value of the property the consultant recommended. The cost of the consultant is considered a “whether or which” investigatory expense and thus is deductible. The cost of the appraiser is one of the specifically mentioned “inherently facilitative” costs and thus must be capitalized into the cost of the building. (Reg. §1.263(a)-2T(f)(iv), example B)

The final cost category mentioned in the temporary regulations are those incurred after the acquisition of the real property, but prior to placing the property into service. Expenses such as repainting the walls or refinishing the floors, which would normally be repair expenses, need to be capitalized into the basis of the property if this expense was incurred prior to placing the building into service. If the expense is incurred after putting the building into service, it does not need to be capitalized. There are a few other exceptions to this general rule, including a *de minimis* rule for taxpayers that issue financial statements, but that is outside the scope of this article.

If you have any questions related to the new temporary regulations or would like to discuss a specific situation related to these temporary regulations, please feel free to contact Mike Gracik ([mgracik@keitercpa.com](mailto:mgracik@keitercpa.com)) or your Keiter Tax professional for further clarification.

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