November 15, 2012

Mr. Andrew Keyso, Jr.
Associate Chief Counsel
(Income Tax & Accounting)
Internal Revenue Service
1111 Constitution Avenue, N.W.
Washington, D.C. 20224

Dear Associate Counsel Keyso,

On behalf of the National Apartment Association (NAA) and National Multi Housing Council (NMHC) we are writing to offer comments regarding temporary regulations issued pursuant to Internal Revenue Code (IRC) Sections 263(a), 168 and 162(a) promulgated December 23, 2011, to be effective for years beginning January 1, 2012, as well as Revenue Procedures 2012-19 and 2012-20 released on March 7, 2012. Collectively, we represent approximately 56,000 members in the multi-family residential and apartment industry in all fifty states while providing safe and decent shelter to over 17 million American households. Our members include large, multi-property, multi-state operators, as well as single property owners and operators. Additionally, we represent professional management companies and developers. Our comments are from the point of view of our collective members, as they and their advisors struggle to comprehend and implement the temporary regulations. We have limited our commentary to significant areas that impact the day-to-day operations of our members in the rental industry.

We appreciate and respect the efforts expended by the Department of Treasury and the Internal Revenue Service (IRS) to create the new guidance, and we are fully aware that these temporary regulations had to cover the full spectrum of business. Our comments are intentionally brief, non technical, and focused on the administrative burden of compliance. In brief, we view these regulations as unnecessarily complex. They increase the difficulty of compliance due to insufficient bright-line guidance and the lack of practical de minimis rules available to all taxpayers. We have reviewed the American Institute of Certified Public Accountants' (AICPA's) comprehensive comments dated July 16, 2012, and agree with their technical assessments and conclusions.

Administrative Burden

At nearly 250 pages in length, the IRS' temporary uniform capitalization regulations are extremely complex and confusing. The temporary regulations offer very little in the way of bright-line guidance, as they rely on "facts and circumstances" determinations from prior proposed regulations and case law. The failure to include bright-line examples will lead to increased effort and expense to comply with the regulations. Furthermore, there is opportunity for even more tax controversy because of varying interpretations of "facts and circumstances."

Turning to specifics, the temporary regulations will impact virtually every aspect of multifamily businesses from the purchase of supplies to replacing or repairing a roof. Operators of multiple properties, with several buildings comprising each property will find compliance even more burdensome as every individual building is now treated as a separate Unit of Property. To illustrate, assume that a taxpayer operates 10 properties and that each property contains 10 buildings. Pursuant to the regulations, this means that expenditures associated with 100 Units of Property and associated building systems must be kept up with separately. This will be a daunting task that possibly will encourage some owners and operators to defer routine maintenance and improvements. We also draw your attention to the potential of increased management fees brought about by the new demands placed on these service providers. We ask that final regulations the IRS ultimately promulgates focus on reducing these administrative burdens to the maximum possible degree. Specifically, multiple buildings within the same apartment community should be allowed to be considered a single Unit of Property for the purposes of these regulations.

To provide just one example of the administrative burden these regulations will generate, one of our members, an operator with several thousand units, estimates that his firm will be forced to add several upper-mid-level employees in several states just to review transactions. Additionally, the firm's accounting and information systems will have to be altered to gather, evaluate, and record transactions. All this effort and additional expense will be required just to comply with the *temporary* regulations. We should all take note of the fact that the expenditures being discussed will all eventually be recognized whether it is currently as an operating expense or in the future as depreciation. Over the long-term, there will not be a net revenue gain to the Federal government. In contrast, multifamily firms will face significant increases in the cost of tax compliance without realizing any benefit from the standpoint of operating a multi-family residential business enterprise.

Use of Examples to Clarify and Illustrate the Requirements and Various Tests Necessary to Comply With the Temporary Regulations.

Although the Temporary Regulations offer approximately 150 examples and the Revenue Procedures offer 2 examples regarding implementation, these examples are discrete in nature and do not illustrate the interactions of the various provisions of the temporary regulations. We strongly believe that any final regulations must use bright-line examples that clarify and illustrate the requirements and various tests necessary to comply with the temporary regulations in a comprehensive and holistic manner. The following examples were extracted from the AICPA'S July 16, 2012, comments to the Department of Treasury and IRS. They offer a comprehensive view of the style and content that is necessary for taxpayers to more fully understand a common repeating transaction in the real estate business.

Example 1: X is in the business of leasing space in an office building that it owns. In Year 1, X discovered that a window in one of the office buildings is broken. Assume that the building, including its windows, is a unit of property under § 1.263(a)-3T(e) and the window is not a rotable or temporary spare part under paragraph (c)(2) of this section. X pays for the acquisition and delivery of a new window to replace the broken window. In the same taxable year, the new window is installed. A window is a structural component of a building; as a result, X recognizes a loss on the disposition of the broken window under § 1.168(i)-8T. Because X has recognized a loss on the disposition of the window, X must capitalize the cost of the new window under § 1.263(a)-3T(i)(1)(i).

Example 2: Assume the same facts as in Example 1, except that X made a general asset account election under § 1.168(i)-1T for the office building. As a result of the general asset account election X does not recognize a loss on the disposition of the window. See § 1.168(i)-1T(e). Because X does not recognize a loss, the window is not an improvement under § 1.263(a)-3T(i)(1)(i). The replacement window also is not a betterment under § 1.263(a)-3T(h), a restoration under §1.263(a)-3T(i), or an adaptation under § 1.263(a)-3T(j). Under § 1.162-3T(a)(1), the amounts X paid for the acquisition and delivery of the window are deductible in the taxable year in which the window is installed in the building.

De Minimis Rule

The temporary regulations establish a de minimis rule with respect to recording small asset purchases throughout the fiscal year. However, the regulations become very complex and confusing in their application with respect to the various applicable ceilings. The appropriate record keeping will, in the vast majority of cases, require a change in accounting procedures just to accommodate the regulation changes. All of this is an unnecessary burden and expense. Additionally, it ignores the fundamental reason that businesses employ a reasonable threshold for capitalization of small asset purchases (i.e., (1) the cost of recording and maintaining the necessary accounting information; and (2) to reduce tax controversy). The use of an arbitrary ceiling of any description adds to the confusion, increases the cost of operation, and creates controversy due to varying calculations among taxpayers.

We are concerned about the requirement that taxpayers use Applicable Financial Statements (AFSs) as the gateway to employing the de minimis rule. As the temporary regulations are presently constructed, a significant portion of our members will be unable to benefit from any de minimis capitalization policy other than the $100 provision simply because they do not have an AFS. This approach discriminates against small and medium-size businesses that do not otherwise have an audited financial statement. We feel that the AFS requirement should be eliminated and ceiling significantly raised due to the additional administrative burdens imposed, their discriminatory nature, and the failure to recognize reasonable business practices. We do not believe that all businesses can reasonably employ the same capitalization strategy. If all are to use the same de minimis approach, then the level would need to be substantially higher in order to cover all businesses. We suggest a more reasonable amount of $5,000. Furthermore, we believe it is logical to adjust the threshold annually for inflation. The requirements in the temporary regulations move us toward businesses existing only for the purpose of paying taxes.

We understand and agree that a reasonable capitalization policy should exist and be used to produce predictable results that do not result in distorted taxable income. We offer an alternative that all business taxpayers be allowed to employ a minimum capitalization threshold appropriate to their operations. We agree that the policy should be in writing. However, we think that reasonable assurance can be given to the IRS with the simple addition of questions to Form 4562, Depreciation and Amortization, much in the same fashion as listed property is handled currently.

Acquisition Cost

The temporary regulations address the capitalization of costs associated with the acquisition of real and personal property at 1.263(a)-2T(f). In general, they require the capitalization of all costs incurred to facilitate the acquisition or production of real estate. The temporary regulations provide an exception to costs associated with investigating whether to acquire real estate and, if so, which real estate (Whether and Which Test) unless the cost is inherently facilitative. The exception essentially provides that if the costs meets the definitions provided under 1.263 (a)-2T(f)(2)(ii) (A) through (K), they must be capitalized.

Our concern is that the temporary regulations, as presently written, require the capitalization of expenditures to certain categories of service providers relative to the acquisition or production regardless of why or when the changes were incurred. We believe this can lead to overstated assets and understated professional fees expenses in the year of the transaction. Furthermore, we recommend that the final regulations require the capitalization of expenditures related to specific activities rather than charges from certain classes of service providers.

Routine Maintenance Safe Harbor, Betterments, and Restoration Rules

Routine Maintenance Safe Harbor

As operators of rental real estate that includes buildings, building systems, and associated equipment, our members are constantly conducting routine maintenance procedures, testing, cleaning, and inspecting. In fact, they must conduct these procedures if they intend to maintain the properties in a habitable, rentable condition. Presently, the temporary regulations provide a routine maintenance safe harbor for property other than a building or a structural component. We believe the safe harbor provision should be expanded to include buildings and building systems. Furthermore, we believe that this approach recognizes the economic realities of the residential rental industry. As part of the final regulations, we also request a clear description of the types of routine maintenance expenses that quality for safe harbor treatment.

Betterments

The temporary regulations require that expenditures for betterments of a unit of property be capitalized if they:

1) Correct a material condition or defect that either existed prior to the taxpayer's acquisition or arose during the production of the unit of property without regard to whether the condition was known at the time of acquisition or production.
2) Results in a material enlargement, expansion or extension or
3) Results in a material increase in output, capacity, productivity, strength or quality of the unit of property.

All of these tests are predicated on materiality, which by its nature is subjective. The temporary regulations on materiality for betterments is a facts and circumstances issue based on purpose, nature of work, effect on the unit of property, and the taxpayer's treatment in its AFS. It is difficult to understand how this will not lead to future tax controversies. We urge the IRS and Treasury to provide a workable and practical definition of materiality in the final regulations. Furthermore, we request additional and clearer examples of the IRS's view of materiality. All of these requests are designed to help minimize future conflicts.

Restoration Rules

The nature of operating residential real estate necessitates periodically replacing parts of building systems as they fail. Given the age of the national residential rental infrastructure, some of these elements can only be replaced with newer, more technologically efficient pieces. The temporary regulations address this issue with the difficult to measure term – practically. In the interest of clarity and minimizing further disputes, we request that the final regulations include a clear definition and adequate examples. Restorations are required to be capitalized under the temporary regulations if the amount paid is for a part or combination of parts that comprise a major component or a substantial structural part of a unit of property. The temporary regulations employ a facts and circumstances test to determine the quantitative and qualitative significance of the part or parts in relationship to the unit of property. The temporary regulations also define major components or substantial structural part to include a part or combination of parts that comprise a large portion of the physical structure or perform a discrete and critical function in the operation of the unit of property.

We are concerned about the lack of bright-line guidance in the facts and circumstances approach and, therefore, request the final regulations include a safe harbor approach and clear definitions for major component and large portion as used in this context. Additionally, we request as many examples as possible to more clearly illustrate the compliance requirements.

<u>Dispositions and General Asset Accounts</u>

Dispositions

The general rules for dispositions provided under Temporary Regulation 1.168(i)-8T(c)(4)(ii) state that each building and structural component (and subcomponents) are to be treated as a separate asset. The very nature of our members' business dictates that the bulk of such assets will be buildings, building systems, and associated personal property used as rental property. The normal course of residential property rentals requires periodic, sometimes frequent, replacement of components used within the buildings (Units of Property). The temporary regulations, as presently drafted, do not offer clear guidance as to when a taxpayer is required to recognize the disposition of a component of a structural component or if the taxpayer has the flexibility to determine that a disposition has not occurred. It should be noted that the improper application of the rules could lead to serious unintended consequences, including the permanent loss of deductions. We strongly recommend that the final regulations contain clear bright-line guidance and an abundance of examples.

General Asset Accounts

It appears that the government is advocating the election of General Asset Accounts (GAAs) for units of property when they are placed in service. The GAA method would allow for the deduction of repair expenses without consideration as to recognition of loss on disposition of the replaced assets. However, taxpayers that do not make the GAA elections will be required to record and recognize the loss in the year that it occurs or risk permanent loss of depreciation expense for an asset previously disposed of, assuming that the repairs do not constitute an improvement as described within the Temporary Regulations. The consequences of being unaware of all nuances and maintaining intricate fixed asset record keeping are unnecessarily expensive. We recommend a more clear, concise and integrated approach for the taxpayer to follow. We believe the approach should recognize the economic realities of the industry being taxed and not create unnecessary burdens on the taxpayer for record keeping or not making an election pursuant to new regulations that contain unclear future outcomes as well as facts and circumstances tests.

Method Change Guidance Revenue Procedures 2012-19 and 2012-20

Revenue Procedures 2012-19 and 2012-20 are designed to provide guidance relative to an application for automatic consent from the IRS Commissioner to change the method(s) of accounting. Revenue Procedure 2012-19 deals with the necessary changes in accounting methods required to comply with the temporary regulations relative to expenses and capitalization of assets. Revenue Procedure 2012-20 addresses changes in accounting methods to comply with the temporary regulations relative to dispositions of depreciable property from traditional accounting methods and GAA methods required. The Revenue Procedures require the preparation and filing of Form 3115, Application for Change in Accounting Method, and the attendant IRC Section 481(a) calculations. The calculations pursuant to Section 481(a) can conceivably produce tax refunds but will not in the majority of cases. In either case, the taxpayer is bound by those elections and must bare the consequences of poor decisions based on unclear, conflicting, and confusing temporary regulations.

We recommend that the issues raised in these comments, as well as those brought forth by the AICPA and other commentators, be addressed and that clarity be brought to any final regulations that may be released before binding elections and accounting method changes are mandated even if that requires a delay in implementation of the regulations. The impacts and implications of these regulations on the residential rental housing industry are significant and must be addressed before compliance is required. Additionally, supplementary guidance should be issued as to combining elections, including GAA elections, on a single Form 3115. Furthermore, additional guidance should be issued to more clearly describe the statistical sampling methods and the extrapolation periods allowed as well as disallowed.

We appreciate the opportunity to comment on behalf of our members and thank you for your review and consideration as final regulations are developed. Please contact Cindy Chetti at NMHC at 202.974.2300 with any questions.

Sincerely,

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