



TAX ALERT

December 20, 2011

IRS: Retirement Communities Depreciable Over 27.5 Years

Synopsis:

On November 25, 2011, the IRS issued a [Chief Counsel Memorandum](#) (Memo) concluding that a taxpayer properly depreciated its retirement communities as residential rental property using a recovery period of 27.5 years under IRC [§168\(a\)](#).

Suggested Action:

Read this tax alert and the Memo (number 201147025) to determine if you may have property that can be assessed for qualification as residential rental property and contact your Reznick Group professional to determine if the Memo could affect your tax position. Please note that the referenced Memo and this Tax Alert cannot be relied on, used, or cited as precedent.

Background:

The Memo described two types (Type One and Type Two) of retirement communities operated by the taxpayer. The Type One community provides residents with a housing unit, personal services and healthcare services with care ranging from independent living to nursing home care on one campus. Residents may transition between stages of care as their individual needs require. Type One community residents do not buy or lease a home, but instead enter into an agreement for continuing care. Residents pay a substantial entrance fee and a substantial monthly fee that is significantly higher than market rates to rent a comparable housing unit.

The Type Two community offers a similar package of services. However, the residents of the Type Two community do not pay upfront entrance fees. Type Two residents sign renewable annual leases, and if additional living or personal care services are desired, a separate monthly fee applies.

More than half of the units in each community are occupied on a non-transient basis. In addition, the taxpayer characterized the monthly fees in both communities as “life care services” income as opposed to rental income.

Issue:

The Memo assesses whether the Taxpayer properly treated its retirement properties as residential rental property with depreciable recovery periods of 27.5 years for purposes of IRC §168(a). Accordingly, the following issues were included in the IRS’ analysis:

1. Are the retirement communities depreciable as residential rental property?
2. Do the retirement community units qualify as dwelling units?



3. Do the dwelling units comprise 80% or more of the retirement community's gross rental income pursuant to IRC §168(e)(2)(A)(i)?
4. Are less than 50% of the dwelling units used on a transient basis?

IRC §167(a) allows for a depreciation deduction for the exhaustion, obsolescence and wear and tear of property that is used in a trade or business while IRC §168(a) provides guidance about the applicable method, recovery period and convention to be used in making depreciation deduction determinations. Accordingly, IRC §168(c) stipulates depreciation recovery periods of 27.5 years for residential rental property and 39 years for nonresidential real property.

In summary, the IRS concluded that the appropriate recovery period for depreciation purposes under Section 168(a) for these communities is 27.5 years for the following reasons:

1. The properties consist of dwelling units that provide living accommodations where more than 50% of the units are not used on a transient basis and where residents have a right to expect to occupy the same residential unit continuously until and unless they have a need for a unit that provides more accommodations. According to IRC §168(e)(2)(A)(ii)(I), dwelling units include a house or apartment that provide living accommodations in a building or structure where not more than half of the units are used on a transient basis.
2. According to the IRS, some allocable portion of the monthly amount paid by the residents is payment for the right to use the dwelling unit despite the absence of the existence of a lease. Further, that portion of the amount paid by the residents is such that 80% or more of the gross rental income from the residential property is rental income from the dwelling units pursuant to IRC §168(e)(2)(A)(i).
3. According to the Memo, the taxpayer's characterization of income as "life care services" as opposed to "rent" does not preclude the property's qualification as residential rental property for purposes of IRC §168.

Contact:

For more information, please visit the Reznick Group [tax webpage](#) or contact your tax [client service professional](#).

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